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ABSTRACT

This document contains papers presented at a seminar to explore how the U.S. economy has created 30 million jobs since the early 1970s, while most European countries have barely managed to keep their labor force employed. The following papers are included: "Job Creation in the United States: Some Facts and Figures" (Sibille); "Unanswered Questions" (Dommergues); "The Unstable Balance between Macro- and Micro-Economic Factors" (Dommergues); "Local Initiatives and the Spirit of Entrepreneurship" (Howell, Daignault); "The Impact of Technology" (Fusfeld); "Measuring Development Progress at State Level" (Friedman); "The Grand Illusion?" (Bluestone); "For the Good of One and All" (Sibille); "Why Partnerships? Massachusetts' Experience" (Stratton); "Economic Development in Michigan" (Plastrik); "Philadelphia's Partnership's for Economic Renewal" (Widner); "Baltimore's Economic Development Partnerships" (Berkowitz); "The Logic of Innovation" (Dommergues); "University, Industry, and Regional Development" (Fusfeld); "Technology Transfers: Carnegie Mellon University" (Jordan); "Centers for Advanced Technology Transfer: The Ben Franklin Partnership" (Singerman); "Evaluating the Ben Franklin Partnership" (Osborne); "Entrepreneurship in the University: The Massachusetts Institute of Technology" (Bloomquist); "Venture Capital and Community Renewal" (Sibille); "The Michigan Strategic Fund" (Plastrik); "Venture Capital: The Engine of Economic Growth" (Lamond); "Informal Venture Capital: Business Angels" (Wetzel); "Banks and Community Renewal: Chicago's South Shore Bank" (Grzywinski); "An Entrepreneurial Approach to the Social Sector" (Sibille); "Economic Development and the New Service Sector" (Kennedy); "Kenilworth Parkside's Resident Managers" (Gray); "Home Health Care in New York" (Surpin); "The Long-Term Unemployed" (Wilson); "Changes in Trade and Distribution" (Dommergues); "Creating Jobs in Retailing: Toys 'R' Us" (Baczko); "The Distribution Sector: Evolution and Perspectives" (Loeb); "Between Fascination and Rejection: Reflections on American Success" (Tordjman); and "What Can We Learn from the Americans?" (Seguin). (CML)

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Mecanisms for Job Creation

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MECANISMS FOR JOB CREATION

LESSONS FROM THE UNITED STATES

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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In 1982 the Council of the OECD inaugurated a new programme in action and cooperation on local initiatives for job creation. The main objective of the programme is to seek how to foster at local level the adoption of new approaches to social and economic development and how to promote the creation of new enterprises and new jobs.

This publication was prepared under the direction of the Secretariat of the Organisation by Pierre DOMMERGUES, Hugues SIBILLE and Elizabeth WURZBURG, Consultants to the OECD

PREFACE

The present publication contains the contributions to the seminar on "Mechanisms for Job Creation: Lessons from the United States", held at the OECD Headquarters on 21st and 22nd January, 1988.

The seminar was instigated by Mr. Philippe Séguin, at that time France's Minister of Social Affairs and Employment, in association with the Secretariat of the OECD's Co-operative Action Programme on Local Initiatives for Employment Creation, and enjoyed the active participation of a delegation of eminent American experts and practitioners led by the Honorable. Dennis Whitfield, Deputy Secretary of Labor in the United States Government.

Chaired by Mr. François Dalle, President of the Comité Stratégique of Oréal, the seminar was based on a simple premise: since the early 1970s, the American economy has created 30 million jobs, while most European countries have barely managed to keep their labor force in employment.

Macroeconomic factors (growth rates, wage and employment flexibility, budget or trade deficits, etc.) cannot alone account for this divergence. The proliferation of initatives and the new vitality of local economies, the adaptability of American society and industry, the spirit of enterprise, and the propensity of public and private actors to take part in development are all factors which help to explain the buoyant employment situation in the United States.

The seminar provided an opportunity to consider the "why" and the "how" of this local buoyancy. The introduction and operation of the many job creation mechanisms set up at regional and local levels are analysed in detail throughout this work.

The OECD was very honored to collaborate closely with the French authorities in preparing the seminar, and to provide a venue for the exchange of experiences and points of view between highly placed American and French experts and practitioners* in the presence of representatives of all Member countries.

The method of inviting panels of French speakers to discuss with American authors their contributions describing concrete and particularly rewarding ventures proved very stimulating. It helped to clarify the underlying values and attitudes, the methods of organization and instruments deployed, as well as the dynamics and results of innovative approaches. This method went further than the stereotyped explanations which too often color the debate on employment creation in the United States.

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* A list of participants is included in an annex.

The aim was not so much to find mechanisms that can be transferred from one country to another as to deepen the discussion and draw lessons -- such as those drawn by the French Minister of Social Affairs and Employment in his conclusion -- which might improve the efficiency of employment action in all Member countries.

Our countries are going through a period of profound change which is also affecting the whole world. Interdependence, competition, and technological progress are combining with rapid new developments in habits, ideas, and cultures. In order to be effective, in other words to provide the growth and progress to face the challenges of exclusion, unemployment, and poverty, economic policy must, much more than in the past, take account of a multitude of parameters which are not specifically economic. In order to play its proper role in the service of governments, this Organisation is obliged to do its best to synthesize the many facets of its activities. At the risk of shocking finance ministries and central banks, I consider that the measures, initiatives and actions described during the seminar and in this publication are at least as important for determining the future of our economies as controlling the discount rate or managing the budget deficit. This is because innovation, "progress", and development, which are qualitative concepts, are better than "growth" at explaining the real nature of the dynamics of the OECD countries.

James R. Gass
Director
OECD Directorate for Social
Affairs, Manpower and
Education

MECHANISMS OF EMPLOYMENT CREATION

LESSONS FROM THE UNITED STATES

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PART I.

THE "AMERICAN JOB MACHINE"

Chapter 1

Job Creation in the United States: Some Facts and Figures

Hugues Sibille

A European View of American Employment Figures

Why the expression "the Great American Job Machine"? The answer seems simple: it is enough to compare net job creation in the United States with that in Europe between 1970 to 1986 -- the crisis period for the western economies. During that period the United States created 31 million jobs, whereas in the four largest European countries, Germany, the United Kingdom, France, and Italy, with a slightly larger population than the United States, the number of jobs has remained the same. Since 1983, the United States has created nearly 12 million jobs, reducing the unemployment rate from 9.5 per cent to 6.1 per cent in 1987. In the same period, the unemployment rate in many European countries rose by several percentage points. The American ability to create jobs was confirmed in 1987, when the United States had 112.4 million people working, an increase of 2.1 million over the figure for 1986.

A comparative breakdown by shorter periods shows that the employment situation in Europe, particularly in France, worsened, especially after the second oil shock.

After creating jobs from 1963 up to the first oil shock, the European economies suffered sharp losses after the second: the EEC lost 650 000 jobs a year between 1981 and 1984 while the United States gained 1.5 million. France did fairly well during those years, but the situation worsened thereafter. As the Dalle Report points out, France found it difficult to face up to the crisis or to summon its resources to reverse the trend.(1)

Comparative Data

Job creation differentials are meaningless without figures showing the number of people in the nation's labor force.

Table 1

NET JOB CREATION IN THOUSANDS
ANNUAL AVERAGE IN THOUSANDS

	1964/73	1973/80	1980/87	1964/87
United States	1 705	2 009	1 903	1 856
France	153	66	-53	64
United Kingdom	14	36	-47	2
F.R.G.	19	-85	-51	-34
Italy	-96	185	49	49

Source: OECD, Labor Force Statistics.

Table 2

TRENDS IN JOBS COMPARED WITH TRENDS IN THE LABOR FORCE

	Jobs (in millions)			Labor Force (in millions)		
	1972	1987	1987/72	1972	1987	1987/72
U.S.	84.6	114.7	30.1	89.5	122.1	36.2
France	21.1	21.5	0.4	21.8	24.1	2.3
U.K.	24.5	25.0	-0.5	25.3	27.9	2.6
RG	26.7	26.0	-0.7	27.0	28.2	1.2
Italy	19.4	21.2	1.8	20.7	24.0	3.3

Source: OECD, Labor Force Statistics.

The growth in the American labor force between 1972 and 1987 was much greater than that in Europe. (Table 2) The American figures could be interpreted to mean that the American economy has created 30 million new jobs since 1972 because 33 million more people have come onto the labor market. The American Job Machine is fuelled by a vigorous demand for jobs: the creation of jobs cannot be separated from the demand for them. Germany, for example, with a relatively stable number of people in its active population had no need to create millions of new jobs. What counts is not how many jobs are created but the economy's ability to absorb a given increase in the labor force. It is in this respect that the European economies have performed less well than the United States, a performance reflected by the unemployment rates.

Table 3

GROWTH IN LABOR FORCE, JOBS, AND UNEMPLOYMENT RATES

	Labor Force Growth 1972/87 (%)	Growth in Jobs 1972/87 (%)	Rate of Unemployment 1972/87 (%)	1987 (%)
U.S.	36.5	35.6	5.5	6.1
France	10.7	1.8	2.8	10.6
U.K.	10.3	2.0	4.0	10.3
F.R.G.	4.5	-2.9	0.8	6.5
Italy	16.1	9.2	6.3	10.1

Source: OECD, Labor Force Statistics.

Interpreting the unemployment figures with reference to the labor force highlights two key differences between the American and French employment situations:

(i) Women have entered the labor market in far greater numbers in the United States than they have in France. Between 1975 and 1986, the percentage of women in the U.S. labor force rose by 12 points, against 3.9 points in France. As a result, two-thirds of all working-age women had joined the American labor force by 1986, compared with 55 per cent in France. This trend has implications with regard to the types of jobs created (as between services and industry) and the rate of remuneration, (supplementary income). And it has other implications less familiar in France, regarding the rate at which women form companies or become self-employed.

(ii) The rate of youth unemployment in the United States fell from 15.2 per cent to 11.2 per cent between 1975 and 1987, whereas in France it rose to 25.6 per cent in 1985. This disparity is partly due to France's delayed post-war baby-boom, and mostly due to young Americans' access to a flexible and expanding labor market.

The Growth of the Service Sector

Of the 28 million new jobs created in the United States between 1970 and 1986, 27 million were in the service sector. Table 4 illustrates role of services in job creation: most of the sectors where jobs are created are in services, and most showing net losses are in traditional industries.

Table 4

EMPLOYMENT DISTRIBUTION AND GROWTH IN THE U.S SERVICE SECTOR

	% of Total Employment			Average Annual Growth Rate	
	1970	1980	1986	1979-80	1980-86
(1) Wholesale and retail trade, restaurants and hotels	21.2	22.8	24.0	2.8	2.4
1.1 Wholesale and retail trade	19.9	21.5	22.4	2.9	2.3
1.2 Restaurants and hotels	1.3	1.4	1.6	2.5	4.2
(2) Transport and communication	4.6	4.3	4.0	1.4	0.2
(3) Finance, insurance, real estate, and business services	8.2	10.9	13.3	5.0	5.1
3.1 Financial institutions	2.0	2.4	2.8	4.1	4.1
3.2 Business services	4.6	6.7	8.7	6.0	6.0
(4) Social and personal services	13.7	14.8	15.7	2.9	2.6
4.1 Social services (educational & medical)	7.4	9.4	10.1	4.6	2.9
4.2 Personal services	5.4	4.3	4.5	-0.2	2.1
(5) Producers of government services	18.3	16.8	16.0	1.2	0.8

Source: Bureau of Labor Statistics.

Comparison of the service sectors in France and the United States reveals several important features:

(i) Tertiary employment is 9 points less in France than it is in the United States, where it accounts for 70 per cent of employment. The share of agriculture partly explains this but industrial employment, (27.7 per cent in the Unites States compared with 31.3 per cent in France), is also a factor.

(ii) Contrary to received wisdom, the differential existed before the crisis, which the Americans entered with an employment structure already dominated by services. In 1970, tertiary jobs totalled 61.1 per cent of the total compared with an average of 45.4 per cent for the four largest European countries.

(iii) The factors usually advanced to explain the growth of services in the United States are: the shift of household consumption toward services; the growth of the information and information technology sector; the predominance of small, less capitalistic business formations; low cost manpower and limited trade union membership; deregulation.

France differs from the United States in two respects regarding the growth of the service sector. First, American companies are far more likely than French companies are to sub-contract their service functions to specialists. American entrepreneurs have three objectives: to concentrate on their own businesses, to reduce the cost of services, and to procure higher-quality specialized services. Secondly, productivity gains in services are distinctly higher in France than in the United States. Job performance in traditional American services is low in productivity terms. Between 1979 and 1984 average hourly productivity rose by 2.2 per cent in France compared with 0.4 per cent in the United States.

Turbulence

In "Job Creation in America", David Birch compares the economy to a storm cloud that, seen from below, appears to retain the same shape, whereas in fact, inside it is a maelstrom of air and water.(2) Similarly, though the structure of companies may remain relatively constant in number and size, this apparent stability masks a continuous movement of company births and deaths, growth and decline.(3)

An analysis of the turbulence in the American economy reveals two major points:

(i) Companies with less than 20 employees are responsible for 88.1 per cent of net job creation, whereas those with over 100 employees are, on the whole, losing jobs. The figures are sometimes disputed but the trend is unchallenged: it is small and medium sized businesses that create jobs.

Table 5

JOB CREATION BY SIZE OF BUSINESS, 1981-85

	Net Job Gains/Losses in Thousands			
Number of Employees	Existing Firms	New Firms/ Firm Closures	Total	%
1-19	1 809.7	753.8	2 563.4	88.1
20-99	603.5	176.8	780.3	26.8
100-499	33.8	-603.4	-569.6	-19.6
500-4 999	58.9	-61.0	-2.0	-1.0
5 000 +	-297.7	435.4	137.7	4.7
TOTAL	2 208.2	701.6	2 909.8	100

Source: David Birch, Job Creation in America.

(ii) The number of self-employed in the United States is growing sharply. According to the Small Business Administration, self-employment has increased by 50 per cent since 1970, with 7.8 million people, 13.5 per cent of the labor force, self-employed. The number of people in paid employment and self-employed increased fourfold between 1979 and 1985. There are several explanations for the steep growth in self-employment in the United States: the job shortage, the need for supplementary income, and the desire for more independence than ordinary employment gives. But it also reflects entrepreneurial initiatives in unexploited market openings.

The Facts about High-Tech Jobs

In France, mentioning "Silicon Valley" or "Highway 128" evokes ideas of plentiful jobs in high-tech industries. This is far from the truth. High technology industries have not created vast numbers of jobs in the United States.

Using a narrow definition of high-tech (firms with 1.5 times the average percentage of employees in technological jobs), according to the Bureau of Labor Statistics, high-tech industries would account for 3 per cent of jobs created between 1982 and 1995. If a broad definition is applied, (percentage of technological employees + research and development spending equal to or above the average), high-tech would account for 17 per cent of job creation.

Although in certain regions of the United States, notably the Boston area, high-tech industries have contributed many jobs, the high productivity of such industries, their limited size, and their need for highly qualified personnel limits their ability to create jobs on a vast scale. But technology has indirect effects on employment which in many cases is considerable.

A Combination of Factors

There is no single reason for the difference between France and the United States with respect to job creation. Some European commentators make the mistake of isolating one factor, such as labor flexibility, and making it the central explanation for the employment situation in their countries. Nor is it easy to measure the effects of the various factors that contribute to the large number of jobs created in the United States, or to fit them into perspective with one another.

The specificity of conditions in the United States -- the size of its domestic market, the size of growth of its labor force, monetary phenomena linked with the dollar, its status as a military superpower, and the federal organization, for example -- makes any comparative analysis a perilous undertaking. An American state is not a French region. The total budget of the 22 French regions is 17 billion francs; the State of California alone runs a budget of $40 billion. The town of Baltimore has a population of 750 000, at the heart of a conurbation numbering 2.5 million. Boulogne sur Mer, a town with much the same type of redeployment problem, has no more than 40 000 inhabitants.

The explanations for the employment growth in the United States include those that are macro-economic in nature, those relating to the application of policies, and micro-economic or cultural explanations which are more concerned with the roles of the actors involved than with the mechanisms of the system.

Growth, Earnings, and Productivity

Explaining the employment differential by the growth of the Gross National Product does not stand up to analysis for the period up to the end of the recession imputed to the second oil shock, as can be seen from Table 6. Over the period 1969-1987, France had an average annual growth in GNP of 3 per cent compared with 2.5 per cent in the United States, whereas employment growth was 0.3 % against 2 % in the United States. So growth is not the key explanation of the differential, in any case not in the long-term. On the other hand, the United States experienced faster growth during the latest period, which may furnish part of the explanation for the differential during the last three years.

Since 1945, labor productivity has been far higher in France with the difference being pronounced, though diminishing, in recent years. The American employment situation is explained by the correlation between the variation in real earnings and productivity. Simplifying, one could say that in France investment has been more concentrated, with real earnings on the increase, and unemployment rising. In the United States, investment resources

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have been more scattered, growth in real productivity and real earnings lower, and employment increasing.

Table 6

EMPLOYMENT, PRODUCTIVITY, AND EARNINGS, 1969-1987
(average annual percentage growth rates)

	GNP	Employment	Per Capita Productivity	Investment	Real Earnings per Employed Person
U.S.					
1969-73	3.2	2.2	1.0	5.7	1.3
1973-79	2.6	2.5	0.1	2.6	0.4
1979-87	2.3	1.6	0.7	1.7	0.3
1969-87	2.5	2.0	0.5	2.9	0.6
France					
1969-73	5.9	1.0	4.9	6.3	5.4
1973-79	2.8	0.3	2.5	1.0	3.5
1979-87	1.7	-0.2	1.9	0.1	1.2
1969-87	3.0	0.3	2.7	1.7	2.9

Source: OECD, National Economic Indicators.

Manpower Flexibility and Mobility

Manpower flexibility and mobility are the most frequently advanced reasons for American job creation success. The length of time people are out of work is an indicator of mobility. In 1986, only 8.7 per cent of the unemployed in the United States had been out of work for more than one year, compared with 47.8 per cent in France and 41.1 per cent in the United Kingdom. Wage flexibility also plays its part: half of the Americans unemployed between 1980 and 1986 were willing to take a lower-paid job than they had held previously, and two-thirds of them were prepared to accept a drop in income of over 20 per cent. The number of women working to supplement family income may contribute to the willingness to accept a decrease in pay.

Manpower turnover is high in the United States, particularly among young people, women, and newly recruited employees, who together form a considerable portion of the labor force. In 1984, 38 per cent of employees had less than two years service, compared with 18 per cent in France. A survey of young people 18 to 24 years old showed that 30 per cent had worked at several jobs during the preceding year.

That Americans are geographically mobile is well known. The pioneer spirit, the size of the labor market, and the relative facility of moving house, in terms of arranging loans and legal fees, for example, make it easier for Americans to re-locate. France, like other European countries, suffers from excessive rigidity in these matters and its wish to do everything possible to maintain the population in an employment area.

Services and small and medium-sized businesses contribute to labor flexibility. They are points of access and even training for newcomers to the labor market.

The concepts of mobility and flexibility are crucial to any discussion of employment in the United States. But Europeans have tended to define that flexibility too much in terms of the labor market and too little in broader terms of social flexibility. It is the whole of American society that is more flexible, not just labor. Capital flows are less impeded, there are more diversified forms of savings and asset holding, and market entry and exit are easier. If labor is flexible but there is no innovation in products or marketing, firms stand still. Some towns in the Northeast, Baltimore in particular, have changed their urban physiognomy in a matter of a few years in order to change to other activities, such as tourism. Would this kind of mobility in capital or infrastructure be possible in France?

The Impact of Federal and Local Policies

Assessing the efficiency of public policies is no easier in the United States than it is in France. It is often tempting to overrate their importance. Winding up a comparative study on the economic policies of different states, Marian Clarke of the National Governors Association admitted that the researchers could not define which types of measures worked and in what conditions.(4) As to the distinction between the effectiveness of micro- and macro-economic policies, that still has to be invented. The point can be tackled by distinguishing between federal and local levels.

Federal Policies

The 1981 Program for Economic Recovery included the following measures:

-- The Economic Recovery Tax Act reduced personal and corporate tax and increased depreciation deductions.

-- The growth rate of federal spending was cut back; defense spending was increased.

-- A sweeping program of deregulation of, for example, transport, telecommunications, finance, and banking was introduced.

It is difficult to evaluate the impact of the program on employment. In general, fiscal reform seems to have had more pronounced effects on capital spending than on savings and manpower supply. Deregulation undoubtedly gave a boost to the economy. The budget deficit affords no explanation of the record

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job creations for the period 1970-1985. Defense spending had little effect on employment.

Federal policies are aimed more at business creation and growth than at the conversion of old firms, and they emphasize risk-taking, entrepreneurship, and partnership. The Small Business Administration has a staff of 4 000 concerned solely with the creation and development of small businesses. Policies supporting entrepreneurial initiative have not been studied closely enough by Europeans.

Those policies include four particularly interesting features:

(i) The use of public contracts as levers for developing small and medium sized businesses, by making sure that they have access to such contracts with the same facility as the large companies (the OPTA program);

(ii) An effective legal and tax instrument, the "limited partnership", which helps to steer private savings toward business creation;

(iii) The frequent use of "leverage", by which public funds are supplemented by private resources, as in the case of the small business investment companies (SBIC); and

(iv) The decentralisation of the management of federal programs, with universities and local authorities providing information and advice to new entrepreneurs.

State and Local Policies

The withdrawal of federal funding led to increased economic intervention at state and local level, on a scale unknown in Europe. According to the National Governors Association, 44 States set aside funds to assist local development, 37 set up an economic agency with a budget for helping business, and 22 established a technology transfer program. The amount invested is said to be $25 billion, $4 billion in direct subsidy with the remainder being spent on improving the business environment.

Two important features characterize the state and local measures:

(i) They emphasize technological innovation, its dissemination, and its conversion into products and services. The programs, such as the Ben Franklin Partnership, discussed in Chapter 16, bring together local authorities, universities, and business in partnerships for research and development, training, laboratory sharing, and venture financing.

(ii) They rest on the ability of cities and states to use financing techniques designed to invigorate the local economy. Underlying some of those techniques are concepts that are as yet little known in France. For example, the development agencies make use of "financial packagers", experts who analyze business requirements, bring investors together, and set up investment packages. The packagers "close the gap", that is, they work in areas not touched by the conventional financial market, using the "leverage effect" to help mobilize funds. The packagers are professionals, often members of the private sector.

Micro-Economic Factors

Over and above the macro-economic explanations, the key elements of the growth in American job creation lie in micro-economic explanations -- national cultural characteristics.

American society faced the economic crisis more quickly than we did in Europe. For a long time we were tempted to shut our eyes to it. American society is more energetic, more mobile, and more flexible than European societies, with their established intellectual habits, social rigidities and difficulty adjusting to change. In the United States, everyone feels responsible for himself, and therefore for his job, and relies on his own strengths. There is less energy wasted in passing the buck and waiting for someone else -- the state, the local authority, employers, or trade unions -- to act or take a risk on one's behalf. Personal responsibility, risk-taking, initiative, consensus, empiricism -- these cultural features contribute as much to explaining the job machine as do macro-economic analysis of the system or pure economics. Behind the system there are always the actors. Four key points should be studied with regard to the behavior of the Americans: entrepreneurship, partnership, the dissemination of innovation, and the movement of capital.

(i) Entrepreneurship

This is the keystone. The enterprise culture dominates American society; there is a consensus in the reliance on business enterprise to create wealth and jobs.

The enterprise movement has produced a record number of company formations -- 668,000 new registrations in 1985. The number of women entrepreneurs is constantly increasing. Between 1977 and 1983, for example, the number of women heads of business rose by 9.4 per cent compared with only 4.5 per cent for men. What is more, according to the SBA, companies run by women are currently performing better. This female entrepreneurship is related to women's increasing participation in the labor force: 64 per cent of the new jobs created between 1972 and 1985 were filled by women.

People who control resources, public or private, behave like entrepreneurs. They are obliged to deliver. Local authorities are often entrepreneurial, and work in the service of business. The public and private sectors cooperate. Despite their seeking different end-results, they share common goals as well, and the movement of actors from one sector to the other is important.

Development agencies created by cities remain under the control of the cities but they function like private sector enterprises, often in close cooperation with the private sector. When they exist, programs to help the unemployed or to revitalize a neighborhood rest less on the idea of social assistance than on entrepreneurial initiatives.

(ii) Partnership

Like entrepreneurship, partnership is a key concept. Partnerships take various forms. Industrial partnerships among large and small businesses feature collaboration for research and development or financing. Social partnerships, like the Economic Alliance for Michigan, discussed in Chapter 7, bring trade unions and employers together to tackle such problems as social welfare, unemployment benefits, and business closures. Three-cornered local partnerships bring together business, local authorities, and universities. The universities play a much greater part than in Europe, one such being the University City Science Center of Philadelphia, which provides a close link between research, dissemination of innovation, and new business formations. The local business community is also active in these partnerships (not always the case in France), like the Greater Philadelphia First Corporation of which the city's top companies are members and which finances any local development projects it judges to be of interest. It is discussed in Chapter 11. These partnerships are not institutional; they function on a project basis. The partners are not there to represent their institution, but to do a job.

(iii) Dissemination of Innovation

While high-tech does not create new jobs in massive quantities, it plays a crucial part in the dissemination of innovation which is the key to development and job creation. David Birch's theory of turbulence holds that growth is attributable to firms with a high level of innovation in a world where the life expectancy of all products is shortening. Birch describes a cascade-type model of creation: business are created, small businesses become medium businesses, medium become big, etc. From the life-cycle of products we move to the life-cycle of businesses, in which innovation is a central factor.(5)

According to that model, the United States is better placed than Europe to engineer the transfer of innovation from where it is generated, in universities and research centers, to the business world. The transfer begins in the large universities, like MIT, that are in communication with business. The various states and the federal government have likewise begun to sponsor purpose-designed technology-transfer and innovation-dissemination programs. Research Development Limited Partnerships (RDLP), for example, were set up to provide tax benefits for investment to encourage research and development (the creation of a high-tech business or the contracting out of a small or medium sized business's research and development budget). The RDLP is a mechanism for bringing research scientists and investors together. Similarly, the Federal Small Business Innovation Research program run by the SBA ensures that small and medium sized businesses are considered for the external research contracts of twelve federal agencies. Between 1982 and 1984, 10 000 projects were selected.

(iv) Movement of Capital

American society is characterized by its readiness to take risks. This is apparent in the financing of new businesses, though not necessarily in the way Europeans might imagine. Of the $40 billion of equity capital invested during a given year in 700 000 new businesses, 80 per cent comes from friends and relatives, or from partners attracted by the "limited partnership" arrangement under which the investment is deductible for tax purposes. High-potential businesses in particular are financed in the start-up stage by private investors who have already made their fortunes. These millionaires make up an informal network ready to finance ventures.

A further 10 per cent of the $40 billion comes from local authorities, as start-up capital, equity loans, or long-term loans. The remaining 10 per cent is provided by banks and formal venture capital sources. The American venture capital sector, (500 companies with 2 000 employees), is twice the size of its European equivalent. Geographically it is highly concentrated, with four States (California, Massachusetts, New York, and Texas) accounting for 87 per cent of the funds collected in 1982. Pension funds have played an increasing role since the 1978 reform of the rules governing them; since 1982 they have represented one-third of American venture capital funds.

There is no doubt that the tax concessions applicable to limited partnerships or venture capital investment play a key role in the mobility of savings. But beyond that there is the attitude of savers who are far more flexible and risk-taking. The French save more than the Americans. France needs to reflect on whether it can tap personal savings for financing business formations, develop a "venture capitalist" profession, and put a larger share of pension funds and insurance company money into risk investment.

Perspectives

Looking forward to the year 2000, three trends are discernible in American employment. Jobs in industry are likely to continue to decrease and jobs in services to rise. In fact, the line between jobs in the two sectors will become more and more blurred because of the diffusion of information and automation technologies on the one hand, and the tendency of industrial companies to contract out their service activities on the other.

The labor force will probably grow more slowly, become older, and include a higher percentage of women and members of ethnic minorities. In the next thirteen years only 15 per cent of new arrivals on the labor market are likely to be white men, compared to 47 per cent today.

The new service jobs will call for higher qualifications and adaptability than are currently required. This will pose mounting problems for populations unable to read, write, count, or carry out instructions.

Concluding an article on the American population at work in the year 2000, L.V.B. Johnston and A.E. Packer identify six problems that decision-makers will face:(6)

(i) How to stimulate balanced world growth and enable the American economy to position itself;

(ii) How to accelerate productivity gains, particularly in services such as health care, education, trade and public services;

(iii) How to maintain the vigour of an ageing active population without encouraging the principle of "two incomes, no children", and how to rejuvenate the labor force;

(iv) How to reconcile the still contradictory aspirations of women with regard to employment and the family when most policies and institutions are designed for a society in which women stay at home;

(v) How to integrate Blacks and Hispanics, who will steadily increase as a proportion of the population, completely into the economy;

(vi) How to improve basic and further training to meet the needs of the new economy which will require more human and intellectual resources.

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Chapter 2

Unanswered Questions

Pierre Dommergues

The creation and growth of small service firms are central to the job creation process in the United States. There are many explanations for the entrepeneurial dynamism of American services: a continuing supply of and demand for services, the expansion of subcontracting, a favorable environment. In the United States, an imaginative and constantly renewed supply, often at competitive prices, provides much of the population with a "service" of some kind or another. This supply precedes and prompts an ever-latent demand. Historically and culturally, Americans are both consumers and co-producers of services. The concept of "self-service" is as widespread as the concept of "ready-to-use service". One type frequently changes to the other, specifically in accordance with market supply and changes in lifestyle. For example, in the distant past, the housewife (or her servant) cleaned her house with a broom; in the more recent past, and now, she (usually the housewife herself) uses a vacuum cleaner; but tomorrow, more and more housewives will turn to house-cleaning firms offering services which were hitherto reserved for businesses.

From Self-Service Economy to Convenience Industry

The ability to alternate between "self-service" and "ready-to-use service" for the same need combined with an unending supply of and demand for services, partly explains the proliferation of small and medium sized firms for the improvement of daily life. It has given rise to the "convenience industry". Certain observers regard this as a "democratic", "modern", and "typically American" substitute for the servant system, which disappeared more quickly in the new world than in Europe. Democratic? Up to a point: very cheap services, such as fast food restaurants or discount shops, are within everyone's reach; others, such as luxury restaurants and the increasing number of upmarket "boutiques", are reserved for the well-off. Businessweek points out to the increasing "polarization" of the consumption of goods and services.(1) Modern? Certainly, since innovation underlies the development. Typically American? Without a doubt, since supply is central to the system.

The "convenience industry" is growing especially rapidly in the areas of education and child care, food, car maintenance, and the retail trade. It is a sector with risks and opportunities: every supplier has to prove that it can provide more convenience for a lower cost.

A Subcontracting Economy

Subcontracting is another sign of the service explosion. It facilitates the life of businesses, which are increasingly eager to buy more sophisticated, more all-inclusive, and less expensive services from specialist firms. Changes in the concept of subcontracting are themselves encouraging small and medium sized businesses to multiply. The industry is being restructured into front-rank subcontractors which supply "modular packages ready for use or assembly", and second and third-rank subcontractors, usually, but not necessarily, located in cheap-labour countries which produce the basic components.

At the same time, subcontracting is expanding to include new sectors, such as management, payroll, pensions, engineering , and mixed systems (set up by joint bodies offering a single office to run complex systems). Specialist firms are being hired to design a part or an assembly, a function which was until recently reserved to the manufacturer. Thus, a virtual subcontracting economy is emerging.

The trend is spreading to most sectors: traditional industries (motor vehicles), leading-edge industries (computers), the wholesale and retail trades, central administration and local government. But subcontracting must not be confused with privatization. Although the latter entails an increase in subcontracting, the current changes are a broader phenomenon which involves the restructuring of manufacturing and management processes.

A "Dematerializing" Economy

The new services have contributed to the growing "dematerialization" of the American economy. They tend to be less and less "at the service of" the basic industries, which are increasingly moving out of the United States. For some people, such as the banker Felix Rohatyn, national independence, (already undermined by foreign funding of the national debt and foreign investment), is threatened by the deindustrialization of America. Hence the debate on the respective places of services and industry.

The alarm was first raised in 1982 by Barry Bluestone and Bennett Harrison. Their study, *The Deindustrialization of America*,(2) examines the loss of productivity in traditional industries, the impact of disinvestment strategies on wage earners, the long-term effects on the local economic and social fabric, the effects on the employment structure and wage trends, and the consequences of the decline of trade unionism. Later, *Businessweek* decried the advent of the "hollow corporation", announcing that "the decline of manufacturing threatens the entire US economy".(3) The article focused on the worrying decline of industry, the troublesome by-products of post-industrial society, the structural fragility of services, and the hazards of unproductive investment.

More recently, in *Manufacturing Matters*,(4) Stephen Cohen and John Zysman echoed the same warnings. In our technologically sophisticated environment, high-tech services are inextricably linked with the mastery and control of manufacturing. If we lose manufacturing, we lose superiority in the most advanced industries. Competitiveness can only be ensured if a new mentality generates new policies in the private and public sectors alike.

Some voices are raised, notably in the Bureau of Labor Statistics (BLS) Monthly Labor Review, which endeavor to put deindustrialization, a tendency that no one denies, "into perspective". Is it not, they ask, a refocusing of American industry onto leading-edge technologies? Between 1972 and 1986, certain industries did indeed experience substantial job creation in absolute figures: electronics (+350 000), plastics (+230 000), radio and television (+200 000), publishing (+160 000), aircraft engines (+160 000), semiconductors (+150 000), measuring instruments (+110 000), and medical apparatus (+90 000). However, looking forward to the year 2000, BLS projects an average annual growth of 2.4 per cent for production and 1.3 per cent for employment -- with the following rates for industry: +2.3 per cent (production), -0.38 per cent (employment).(5)

Productivity and Employment

Japan and Europe have experienced considerable productivity growth in recent years, but they have created few new jobs. The United States, on the other hand, has created many jobs, but its productivity rate is still low. The trend may eventually bode ill not only for competitiveness but also for employment. Wages have not risen coincidentally with productivity improvements.(6) The correlation between low productivity and high job creation is particularly evident in certain services, such as hotels, restaurants, and retail stores, which offer the majority of insecure, badly paid jobs.

Under pressure from international competition, however, American productivity has already improved in certain industries and in some business services. Due to the growing sophistication of management strategies, similar developments are occurring in the wholesale and retail trades, where improved productivity is a prerequisite for survival. These, notably, are the conclusions of studies of the distribution sector by Walter Loeb, President of Morgan Stanley Investment Research, which are discussed in Chapter 30.(7)

The United States no longer enjoys its former lead in productivity, and its previous, relatively small involvement in international trade has increased. Its major problem now is how to raise productivity. Can it do so quickly enough? What effect will it have on employment? Finding answers to these questions raises difficult policy choices.

Employment and Inequality

The jobs created in services other than business services tend to be insecure, part-time, unproductive, low skilled, and badly paid. Most of them are held by women. This state of affairs has fed the debate on social polarization, increasing inequality, and the decline of the middle class.

Once again, Barry Bluestone and Bennett Harrison launched the debate. In their report, "The Great American Job Machine", prepared for the U.S. Joint Economic Committee, the authors examined the proliferation of low-wage employment in the US economy.(8) They pointed out that during two periods, 1973-79 and 1979-84, job creation was accompanied by a sharp rise in low-paid employment, a smaller rise in high salaries and a substantial fall in middle-level earnings. Further, the proliferation of low-wage jobs was due to the rise in part time work and the increase in unskilled and underpaid employment. And finally, the underpaid workers included white male adults, not only young people, women, and ethnic minorities.

The report was greeted with hostility by certain politicians and journalists. Bureau of Labor Statistics officials' reactions were more measured. While they agreed that the employment market was to some extent bipolar, they wholly disputed the report's conclusions and suggested different interpretations of the facts. For example, the proliferation of low-wage jobs might be a cyclical phenomenon which should be placed in the long term.(9) Robert Lawrence of the Brookings Institute argued that it was a passing phenomenon linked with the arrival on the labor market of the children of the baby boom. (10)

Bluestone and Harrison refined their argument in The Dark Side of the Labor Market: Flexibility, Falling Wages and Growing Income Inequality in America.(11) They examined the trend in a longer period, analysed more detailed BLS data, and placed the development of low wages in the broader perspective of the rise in inequality generally. This report, published recently, is the starting point for a new discussion on ways of eliminating the trend toward social polarization.

Admittedly, the unemployment rate is low and the duration of unemployment short (an average of four months, compared to seven to ten months in Europe). But many wonder whether the present prosperity is not based on an army of unemployed people who want to work and who are not officially counted anywhere, and on another still bigger army that works for wages below the official poverty line.

The New York Times studied these armies in a feature story in September 1987.(12) According to the Bureau of Labor Statistics, unemployment has fallen from 10.7 million (9.5 per cent) in 1983 to 7.3 million (less than 6 per cent). But there are 6 million discouraged workers in America, (nearly as many as the declared unemployed), who want work but have given up looking for it. Of discouraged workers, 67 per cent are women and 23 per cent men; 72 per cent are white, 25 per cent are black, and 3 per cent belong to other races; 26 per cent are between 16 and 19 years old, 16 per cent are aged 20 to 24, 50 per cent 25 to 59, and 8 per cent are 60 or more years old. Also overlooked are the 17.9 million Americans who, according to BLS statistics, "float" between one trade and another. They work full or part-time for less than half the year for an annual wage of under $11 200. "Floating" workers represent 15.7 per cent of the 115 million employed Americans. If the 6 million discouraged workers were included in the official statistics, the unemployment rate would nearly double. If "floating" workers were taken into account, the United States unemployment rate would be not less than 6 per cent but 26 per cent.

The BLS statistics underline the growing inequality in income distribution in the United States. The share of total income received by the 20 per cent of wealthiest families was 43.5 per cent in 1985 -- the highest figure recorded since the index was introduced in 1947 -- compared to 41 per cent in the preceding decades. The share of the 60 per cent of poorest families was 32.4 per cent -- the lowest figure recorded since 1947 -- compared with slightly under 36 per cent in the 1960s.

Today, inequality is not due to a more uneven distribution between age groups but to the growing disparity of income within each group. It cannot be assumed that relative incomes will rise automatically with age. If the income of the children of the baby boom is now lower because of demographic pressure, that pressure will still be present when they are 40, and their wages will rise more slowly than those of the preceding generation, which was not affected by the same competition. In 1960, a 40-year-old employee earned double the average wage he earned at 20. In 1980, the rise was only 16 per cent. The prospects are even worse for today's young people.

Women are increasingly entering the labor force, although more women than men work part-time. Women's earnings are 52 per cent of their male colleagues', 65 per cent if they are employed full-time, year-round. The increase in the number of single women heads of households contributes to the growing "feminization" of poverty.

Americans are paid less per hour of work, but average household income has changed little. This may be because people are working longer hours, or because of the increase in two-earner families.

Leaving aside the issue of the increase in low-paid jobs and the polarization, or dualism, of American society, analysis of the employment climate in the United States reveals several features:

-- There is a downward flexibility of earnings.

-- There is great diversity in the way firms cover social costs, (from the total absence of coverage to coverage by insurance included in the calculation of labour profitability).

-- The cost of labor is tending to become the principal adjustment variable at aggregate level, to the detriment of productivity and quality of labor.

Those features reveal a paradox. While local decision-makers emphasize an approach based on assessing the strengths of the region, the cost of manpower emerges as the main regulator of the employment market, at the expense of considerations concerning the quality and capital represented by a trained workforce.

A Global and Personal Response

Work entry or re-entry programs, (and assistance programs for the elderly and the handicapped, where they exist), are striking by their twin global and personal approach. The work entry centers (notably in Detroit and Boston) have two innovative features:

- They give preference to the precise target rather than the mass operation, and endeavour to measure efficiency.

- They are "inter-institutional", tackling work entry problems comprehensively (including health, housing, and education problems). They do not isolate services. This is not inconsistent with a very personalized approach which takes up the challenge of adjusting to specific individual progress.

Certain American programs for getting the unemployed back to work appear more innovative than those introduced in Europe. They operate with the financial participation of the firms concerned and feature the use of technical teams consisting of professionals and trade unionists. They do not rely solely on "outside" experts. Thus, Massachusetts'Industrial Services Program provides, at one and the same time and within the same community, logistic support for the unemployed, (in association with their unions), and for small businesses which have technological adjustment, management, or investment problems.

The task of Private Industrial Councils (PICs) is to draw up work-entry and re-entry vocational training programs for local communities. Generally, the programs are proposed and funded by a local partnership between members of the public and private sectors. The public funds come either from the federal government under the Job Training Partnership Act, or from the various local authorities.

In Massachusetts, the aim of the PICs is to raise hopes of economic integration, to improve secondary schooling, to involve the business community in economic development, to encourage cooperation among public agencies, and to inform the public. The nature of the information disseminated is striking. The booklet describing Massachusetts' training programs, prefaced by Governor Dukakis, opens with four pages of information about the State's weaknesses. It points out that although the unemployment rate in Massachusetts is one of the lowest in the country, half a million people, (a third of whom work), live in poverty. Some 30 to 50 per cent of the workers put out of work by factory closures, who must learn a new trade, can neither read nor write. In "the best educated state in America", 30 per cent of all adults have not attained primary level education; one pupil out of every four drops out of school before completing his or her studies.

It is problems such as these that public/private partnerships are trying to eliminate by tackling them at their roots in a comprehensive way.

A Strategy of Local Alliances

The alliances which are breathing new life into the economic, social, and cultural fabric of the United States are fundamentally different from the now extinct "great coalition", which helped to revive the American economy in the 1930s and 1940s. The new alliances are local, not national: they are built up around specific projects which concern the local community, instead of being national programs which until recently tried to mobilize the entire nation.

Local projects provide the core for a "territorial economy", a "territorial policy" or even a "territorial company". But economic alliances assume local political alliances which do not always take account of decisions at national level, and these political alliances are not concerned with economic development alone. Thus, in Detroit, TEAM -- an association co-chaired by the former vice-presidents of Ford and of the auto workers' union -- has succeeded several times in wresting a consensus from the Michigan legislature on problems such as the financing of the state's budget deficit or the reduction of health insurance costs without impairing the quality of care.

It is in the economic area that the performance of the local partnerships has been most spectacular. The same approach may be found, often with the same success, in the social sector, as demonstrated by initiatives like those at Kenilworth Parkside in Washington, D.C., discussed in Chapter 25.

In the right conditions, a certain consensus can help to launch actions which are judged only according to their target and effectiveness. Dividing lines are removed, feedback is counted on. Funding is spoken of against the criterion of profitability, and the American equivalents of French social workers are adept at using the available financial mechanisms.

The involvement of various actors in the settlement of or approach to problems assumes effective decentralization and autonomy of action. Universities are independent in their choice of teaching subjects, their sources of funding, and the use made of their laboratories. States make legislative decisions concerning the range of their economic and social programs and their taxation policies. Partnerships are based on contracts. It is important, therefore, that the actors' contractual capacity really exists.

Partnership structures are immediately operational and stable. Usually created with state support, they are mixed (quasi-public) or private, non-profit bodies. They have a community service vocation but are managed like private firms. They are often in competition with similar bodies. The quality of the service provided and users' assessment are the keys to their success or failure.

With many variants, partnerships operate in most vital sectors: applied research, industrial research, initial, continuing and on-the-job training, regional economic development, fund collection clubs, health services, and inner city rehabilitation.

The generally tripartite funding from government, private foundations, and business is organised in an incentive order. During the first year, the government share is largest; in the next year, government and foundation contributions are equal; in the third year, foundation aid stays the same, while public funds fall slightly and there is an injection of private capital. After five years, a "big project" should become financially independent.

In order to succeed, partnership practices call for new forms of solidarity based on decentralization and the involvement of all local actors. They also imply that each partner profits from the cooperation, that each has a decision-making role, and that potential wealth is optimized in a fairer context. The partnership may or may not be democratic. The firm must demonstrate a new civic spirit; local government must invent a new accompanying role; workers must explore new areas of negotiation. The diverging interests are as numerous as the converging targets in the alliances being set up at local level. The rules of the game are increasingly complex: competition is sharper than ever, and yet it is necessary to learn the art of working together.

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PART II.

THE UNITED STATES ECONOMY AND JOB CREATION

Chapter 3

Introduction to Part II: The Unstable Balance Between Macro- and Microeconomic Factors

Traditional methods of macroeconomic regulation no longer work. Civil and military Fordism, Taylorism, and Keynesianism have proved powerless. The tendency toward national government disengagement is affecting all industrialized countries. Is the new balance to be found at microeconomic level?

Pragmatic and individualized approaches seem better suited to an ever more complex world. Giving greater responsibility to smaller units -- the district, the city, the department, the region -- is both desirable and necessary. The wind of decentralization is now blowing as strongly over the most centralized countries as over those with a federal tradition.

Local partnerships seem more efficient than national coalitions. They are better at catalyzing territorial potential.(1) They allow cooperation with distant and, until recently, inaccessible partners. They strengthen economic and social cohesion in communities. They promote an integrated environment, which is a source of wealth and employment. They place their trust in both intelligence and technology. They provide a balance between large and small companies.

Partnerships take many forms. They practice the rules of conviviality as well as those of professionalism. They are central to the processes of exploiting existing resources. While they need time to mature and sometimes require a change of mentality, partnerships can also engender new forms of local solidarity.

In Chapter 4, James Howell and Linda Daignault stress the importance of corporate community behaviour to successful local initiatives. In the absence of community cohesion, economic development based on local initiatives has little chance of succeeding. The authors also emphasize that any local economic development program, whether it concerns the integration of marginal groups or the members of ethnic or racial minorities, must operate in accordance with the rules of the market economy. The market economy's imperfections cannot be overcome by strategies of material assistance, like outright grants, but must be addressed by intangible assistance such as training, counseling, and new methodologies.

The State as Stimulus and Guarantor

Decentralization must not erase the role of government as stimulus and guarantor. More than ever, the state needs to promote equity in a world in which regional disparities are increasing as sharply as the competition between cities, departments, and regions. It should provide solidarity in a society in which individual disparities increase inequality in incomes, in the degree of freedom enjoyed, and in the right to education and training.

Local governments, which inherit many of the prerogatives formerly exercised by national government, should be instigators, companions, encouragers, and co-ordinators -- but not the managers -- of partnerships which they entrust to qualified operators belonging to an association or to the private sector. Government must often invest substantial public funds either to crystalize innovation, to create leverage, or to fill in the gaps left by the financial market. The public sector is central to concerted local technological, economic, and social consultation policies.(2)

This concerted action is only possible, as Herbert Fusfeld points out in Chapter 5, in the context of technological progress which is wider than national borders and is fed by the free movement of technological information. Yet technological progress has its contradictions: without it, productivity and quality stagnate, but its advance is initially responsible for the loss of certain jobs and exacerbates the competition between cities, regions, and nations.

The World Context

Local economic development efforts must take into account the territorial economy's place in the world economy. An insular local or national economy is condemned to decline. The regions which develop, the businesses which prosper, and the innovations which create wealth and employment are those with international ambitions. Successful local development strategies incorporate a global view. Cities, departments, and regions must view their strengths and weaknesses not only with respect to their immediate competitors, but also with respect to the world market. The desire for cooperation and a competitive spirit are two facets of the same approach. The ability to form an alliance with a competitor, be it another firm or another city, and identify and conquer a market is essential.

Important though it is, microeconomic development depends very much on, and therefore must allow for, macroeconomic events. A falling dollar or rising rate of interest can have a more immediate and lasting impact on the automobile industry and the economic fabric of Michigan than, for example, the sophisticated technology transfer practices painstakingly set in motion by all the local partnerships in the State.

It is essential today to define a local strategy. In Chapter 6, Robert Friedman describes new criteria which enable cities, counties, states and even regions to identify their strengths and weaknesses and, above all, to create medium- and long-term economic development schemes. He suggests four factors to be taken into account in assessing a state's business climate: performance, vitality, capacity and policies.

Endogenous Development

Is the resolutely decentralized approach a fundamentally new phenomenon in the United States? It was at state and local level that problems arose and solutions were found during the first American industrial revolution. During the "progressive" period, most of the reforms took shape in the cities or states before being institutionalized at federal level and incorporated into the national New Deal policy. President Roosevelt said that nearly everything achieved at federal level resembled what Al Smith had instituted as governor of New York.

What are the common denominators of regional and local economic development policy now? Following a phase during which each city and state had set out on a "hunt for businesses", the new strategies aim to stimulate the local economic base and to encourage endogenous development. Instead of directly helping a particular industry or a specific process, the objective is to generate technological innovation, capital formation, the marketing of research, and business creation.

The participation of all partners is essential to the process of revitalization. It must include not only business, universities, and local governments, but also the trade unions. In Chapter 7, Irving Bluestone stresses the importance of cooperation between employers, unions, and the public sector in matters much wider than the drafting of collective bargaining agreements.

It is of course difficult to assess the impact of regional and local policy on business and employment creation. How is the role of each partner to be measured? How can motivating factors be quantified? How can a distinction be made between the results of local efforts and those influenced by the world environment?

Similarly, the balance between microeconomic and macroeconomic factors is difficult to find and still more difficult to evaluate. In the absence of a regional economic strategy, the local fabric deteriorates. But the health of the local fabric is very sensitive to the world context -- which it itself helps to shape. The stabilization and revitalization of local economies based on local alliances can only fully succeed in the framework of more concerted international economic action.

Pierre Dommergues

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Chapter 4

Local Initiatives and the Spirit of Entrepreneurship

James M. Howell and Linda Daignault

Recent years have witnessed an intensifying interest in the remarkable job output of American capitalism and its implications for Europe, an interest that was significantly strengthened by the extraordinary turnaround in the Massachusetts economy during the late 1970s and early 1980s. From 1968 to 1975, New England lost 252 000 manufacturing jobs. In 1975, Massachusetts had a 15 per cent unemployment rate, and 1.25 million of its 5.6 million residents were on public assistance. Today, the unemployment rate in Massachusetts is less than 3 per cent.

The Massachusetts revitalization seems to hold special interest for European elected officials and economic development practitioners because of historical parallels in the process of industrialization. Because local economic initiatives are frequently cited as having contributed to Massachusetts' growth momentum, the State is of particular interest to those seeking to enhance the economic well-being of their local areas.

The impressive job creation process in the United States has continued under four presidents, each pursuing his own macro-economic policies which, for better or worse, created radically different economic environments. The consequences have included episodes of wage and price controls, tight central bank policy, protracted inflation, and radical tax changes resulting from supply-side economics.

Yet, despite the wide range of policies, the United States economy has continued to produce new job opportunities, a phenomenon which has led some European observers to conclude that local economic initiatives, not macro-economic policies, have made the critical difference in job creation. Admittedly, these initiatives can play a useful role, -- especially in an environment where growth is taking place. But a region cannot escape the ultimate impact of macro-economic policies on its economy. Accordingly, national growth patterns and their impact on the effectiveness of local initiatives must be considered.

Patterns of U.S. Economic Growth

The job growth rate in the United States since the mid-1960s has been remarkable, but it has been shifting and unevenly distributed regionally. In retrospect, the years of strong city/urban building in the Sunbelt (1965-1975), the energy-driven growth years of the Southwest (1974-1982), the re-emergence of the country's international service centers such as New York, Chicago, Boston, San Francisco, and Los Angeles (the early 1980s), the technological revitalization of Massachusetts and New England (the late 1970s into the early 1980s), and the new growth corridor currently developing on the Eastern Seaboard, from New York into New Jersey and Philadelphia, can be distinguished. This strong growth in selected regions reflects the disaggregated developments within specific industries in response to international demand, technological innovation, and industrial shifts in the United States.

In sharp contrast to those examples of regional growth, a number of regions in the United States continue to languish from secular declines in the competitiveness of their industry mix. Most notable are the Farm Belt and the steel/auto regions in the Great Lakes -- although their economic difficulties have evolved for different reasons and over different periods.

In the United States, job creation has begun to alter the wage structure of labor markets: job growth has been concentrated in low wage occupations. For most of the post-World War II years, the United States labor market was characterized by considerable upward income mobility as productivity gains were filtered through the occupation structure. By the mid-1970s, however, this traditional labor market trait began to give way to what has now been characterized as a dual labor market, a market with strong demand for the professionally educated at one end, and for low wage, entry level labor at the other. From a public policy standpoint, this duality is a matter of concern. It implies that labor market dynamics may well be creating a two-class society. Rapid job growth is not entirely free of public policy concerns.

Local Economic Initiatives in Perspective

For the past decade, there has been a trend in the United States toward political decentralization, devolution of the federal government's spending authority, and diminished federal funding. Whereas during the Carter years, in Fiscal Year 1980, federal grants for economic development, education, and infrastructure amounted to approximately $85 billion, they are now approximately $60 billion annually. As a result, the "leveraging" of local economic development program funds has become very important. Leveraging increases the economic benefits to be derived from the expenditure of government funds by using them to stimulate private investment, especially in areas where the market, on its own, might not lead to it.

In this context, it is instructive to explore the aspects of local economic initiatives that proved so intriguing to the recent French OECD mission during its visit to the United States in late 1986: entrepreneurship and partnership. The Report of that mission observed, first, that "entrepreneurial initiative permeates every sphere of activity" and, second, where Europeans saw themselves tending "to look for things which divide us, the Americans...were interested in what might unite them."(1) The Report added that the latter characteristic enables Americans to break down barriers and to make the most of new resources.

Entrepreneurship

Entrepreneurs are different from business managers. They go against the grain and deviate from the norm. The profile of the typical Massachusetts entrepreneur reveals an individual highly motivated by family background, whose entrepreneurial activities usually occur before he is forty years old. A majority of them, 50 to 60 per cent, them had self-employed fathers.

Entrepreneurs are clustered in Massachusetts, California, and Texas -- they emerge from the educational networks in those regions, and those educational networks are the fundamental factors that attract them. There is an expectation in the American academy to be entrepreneurial. For example, four Massachusetts Institute of Technology laboratories alone generated over 200 companies, or technology transfers, during the ten-year period ending in the mid-1970s.

Just as entrepreneurship combined with partnership creates the technology transfers which allow venture capitalists to make money, communities are revitalized by partnerhips founded on community entrepreneurial behavior. Sometimes the activities of community entrepreneurs are in fact partnerships, and sometimes they are more diffuse grass-roots community efforts which rely on the energies of one or two individuals. Whatever their formal structure and goals, their key characteristic is that they are locally initiated efforts to create change in a community.

Criteria for Economic Development Programs

The Economics Department of the Bank of Boston and the Council for Economic Action, a Boston-based economic development consulting firm, have for many years been involved in local economic development projects both in New England and elsewhere in the United States. While their programs do not always fit neatly into a generalized partnership mold, they all share two fundamental principles. First, the programs rest on the conviction that successful local development initiatives are built upon "pull together" attitudes that encourage change. If these attitudes are not in place, local leaders can make them a reality. Without community cohesiveness, locally initiated economic development is likely to fail.

Second, program goals, aimed specifically at new business development, and ultimately at job creation, must be functionally compatible with the workings of the market economy. A program that cuts against the grain of market fundamentals will either fail or will achieve only modest results. Accordingly, access to capital markets is crucial.

The following presents examples which illustrate the importance of these criteria.

Encouraging "Pull Together" Attitudes

The first steps in building a community consensus for change are recognizing that an economic problem exists, making a convincing case that the community can overcome the problem, and creating the momentum to do so. At the outset, concern about economic development and job creation needs to be transfered from a small leadership group in the community to a broader base of opinion-makers. Various institutional interests -- educational institutions, financial institutions, government agencies, political organizations, and community leaders -- must be identified and involved in the process of mobilizing the community to assume the task of economic development and job generation.

a) The Boston College Citizens Seminars

In reflecting on the remarkable renaissance of Boston, nearly all observers have cited the importance of the Boston College Citizens Seminars in mobilizing the area's leadership to counteract the steep decline in the regional economy. The Citizens Seminars convened a series of experts to discuss specific questions -- financing regional mass transit, for example -- before a broad spectrum of area leaders, to focus the attention of the community on specific development issues. This facilitated the creation of innovative programs to deal with the issues identified. The seminar series is now twenty years old, and illustrates how a university-led effort can create an environment in which more specific partnerships can emerge.

b) The Akron Roundtable

Akron, Ohio is a midwestern town left in seriously deteriorating financial and economic straits by the demise of its traditional tire and rubber industries. William Muse, the president of the University of Akron, has launched a year-long series of community seminars in which key articipants from cities that have successfully mobilized local development rocesses have been invited to come to Akron to lead day-long discussions on ocal leadership and urban regeneration. Participating cities in the University of Akron seminars include Dayton, Ohio; Rochester, New York; New Brunswick, New Jersey; and Lowell, Massachusetts. The goal of the seminars is to build community awareness and a sense of public participation in Akron.

c) The Liverpool Forum

The University of Liverpool, having studied the revitalization of New England, is trying to transfer the community consensus-building role that some American universities have played into a European context. In June 1988, Graeme Davies, Vice-Chancellor of the University of Liverpool, with other community leaders, hosted a two-day seminar to discuss the lessons of the Massachusetts revitalization and their potential applicability to Liverpool. The Massachusetts delegation was led by former U.S. Secretary of Housing and Urban Development, Robert Wood, and also included bankers, developers, and government planners. The seminar included a public presentation for the community, and smaller, private encounters among leaders from both sides of the Atlantic. The goal of the seminar was to stimulate the local leadership of Liverpool into creating an atmosphere hospitable to change and to economic revitalization.

d) The Blackstone Valley Experience

Like universities, community political leadership can initiate change. The Blackstone River Valley, which connects Worcester, Massachusetts and Providence, Rhode Island, for a long time lagged behind all regional revitalization efforts. The Valley's anchor city -- Woonsocket, Rhode Island, a textile manufacturing center -- demonstrated strong resistance to change, even though substantial federal government grants flowed into the city.

But recently, State Representative Richard T. Moore's ten-year effort to reshape community attitudes has begun to produce results. During the 1980s, Representative Moore sponsored numerous economic development conferences for diverse leadership groups, and he hosted private sessions with business leaders throughout the Valley. The Valley is beginning to be transformed and to be integrated into the rapidly growing Boston-Providence axis.

e) Lawrence, Massachusetts

A final example will show the importance of community mobilization in the process of local economic development. Only twenty miles east of Lowell, which has recently enjoyed considerable growth, Lawrence, a city similar to Lowell in industrial history and structure, still struggles, despite carefully outlined strategies, even to begin efforts at economic revitalization. Attempts to replicate the Boston College Citizens Seminar program with a local college have yet to come to fruition. The difference between the two cities results from strong, broad-based citizen involvement in one city and the inability to generate similar involvement in the other.

Recently, the Mayor, the State Representative, and the U.S. Congressman for the area have deemed the situation in Lawrence "critical", and they are beginning to demand results. The banking sector is beginning to show an interest in Lawrence, but a broad community consensus has yet to emerge. Clearly, as this example shows, community consensus-building is critical to the success of U.S. efforts at economic revitalization. The importance of "pull together" attitudes for economic change should not be underestimated.

Working Within the Market Economy

Program goals and implementation must be compatible with the profit maximization principles that guide resource allocation in the market economy. But the market does not function perfectly. It is surprisingly ineffective in providing accurate and up-to-date information about market opportunities among existing industries and their ability to absorb new entrants. If this information barrier can be overcome, entrepreneurs can find new avenues to success. Work at the Council for Economic Action has demonstrated that these gaps in the market mechanism, when identified, can provide opportunities for growth.

The Council has developed a technique to identify undersupplied businesses which, because there are fewer firms than local population or income would support, can be relatively easily started or expanded. As a result of the Council's activities, other communities throughout the United States are now using the technique as the basis for structuring their job generation programs. The following highlights some examples:

a) Creating Small Businesses for Lagging Areas and Minorities

In Boston, Massachusetts; Stockton, California; Milwaukee, Wisconsin; and other program sites in the United States, academic institutions have joined local governments and voluntary organizations to become active participants in preparing minority entrepreneurs for new business development opportunities based on the market analysis of undersupplied industries. In the first two years of program operation, almost 1 000 students have completed these specialized training courses and about 15 per cent of them have already started or expanded businesses.

In contrast to other minority business development programs and regionally targeted assistance programs, the Council's Small Business Development Program offers no grants, subsidies, or special guarantees. Rather, it emphasizes improved information about markets, strong educational training, and intensive follow-on technical assistance. Completing the education program prepares participants to compete in the market on an equal footing with other businesses. To this end, participants emerge from the program with a comprehensive business plan.

In Milwaukee and Stockton there has been strong participation by two different minority groups: Southeast Asians and Blacks. In Stockton, about one-third of the businesses created or expanded have occured in the Southeast Asian community, a particularly significant participation rate given that Southeast Asians are estimated to comprise only 10 per cent of the city's population. Among the businesses started were an auto repair shop, catering services, and a video rental store. In Milwaukee, 80 students have attended the Minority Entrepreneurship Program since July 1985. Cooperation between the Milwaukee Afro-American Council Foundation and the University of Wisconsin-Milwaukee has been crucial to the development of the program.

The Milwaukee and Stockton programs illustrate local initiatives to reach groups within urban neighborhoods often ignored by the dynamic forces of economic growth in the metropolitan economy.

b) Import-Replacement Markets

Cities develop primarily through industrial specialization. While growth in the export base has, at least up to now, been sufficient to sustain urban employment and income levels, additional economic and job benefits can result from programs to accelerate the creation of firms in import-substitute industries. In some instances,the existence of dominant urban areas has created an incomplete or underdeveloped pattern of industry growth in medium-sized cities which purchase significant amounts of goods and services from their larger urban neighbors. Identification and exploitation of situations where there is a high level of import dependence can create jobs in medium-sized cities. The Council pioneered a methodology to identify potential import-substitute industries. Programs in Virginia and Tennessee illustrate how the methodology works.

The Council conducted a business survey among potential import-substitute industries in Norfolk and Portsmouth, Virginia, whose larger contiguous urban areas are Washington, D.C. and Richmond, Virginia. It identified 185 existing businesses, such as computer programming services, china and glassware wholesalers, photofinishing laboratories, bakeries, and business form printers, that expressed a strong desire to expand. Most of the managers of those enterprises were unaware that they were part of the import-substitute base or that there was a unique opportunity to expand their market shares. A similar survey conducted in Chattanooga, Tennessee, identified 168 businesses interested in expanding in import-replacement industries. They included dental laboratories, screen printers, and contractors for prefabricated metal buildings.

Because of the precision with which the Council's methodology can pinpoint import-substitute industries, it offers new opportunities in urban program design within the framework of the market mechanism. In Norfolk, Portsmouth, and Chattanooga, partnerships involving education institutions, civic leadership, and the financial community are spearheading efforts to facilitate growth in businesses and jobs among the import-replacement industries.

c) Accelerating Growth between Two Growth Poles

During the past several years a growth corridor linking Boston with Providence and Worcester has arisen as a result of growth in those cities. That growth, which will continue into the next decade, combined with a reconstructed Route 146, will result in the emergence of a third growth corridor, from Providence to Worcester through the Blackstone Valley. But, as the Council's experience has demonstrated, most businesses in the two anchor cities and in the corridor will be slow to perceive the economic significance of the covergence of the Providence and Worcester economies.

If the relevant industries can be identified, the Valley can accelerate local job generation at a pace considerably faster than would have resulted from market dynamics alone. In response to the anticipated growth, the Blackstone Valley Regional Development Corporation requested the Council to undertake a comprehensive analysis to target the industries most likely to experience growth in the Worcester and Providence metropolitan areas. The multi-jurisdictional character of the region complicates the project -- there are eleven cities and towns in the Valley with competing interests -- but change has at last begun.

d) Identifying Special Market Niches

For decades, most economists and planners have failed to devise new development strategies for mature industries in established economies. But now it appears that U.S. manufacturing has been more innovative in some areas than had previously been the case. A recent book entitled Invisible Factors in Local Economic Development,(2) documents new manufacturing growth among mature industries in the Montachusetts region of Massachusetts, an area approximately 20 miles west of Boston. These industries were concentrated in

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machinery, printing, and plastics. The authors note that new industrial development has taken place and that, despite obvious cost disadvantages, product specialization within established businesses was encouraged.

The strategy has not been to rely heavily on a high technology growth strategy, but rather to concentrate on firms and products with special market niches that draw strategically on labor flexibility and the other strengths in the existing economic base. The local business community has seen the initiative as a viable alternative to high tech development and has made a multimillion dollar commitment to its success.

Access to Capital Markets

A fundamental element of the Council's philosophy is that new business development schemes must meet the discipline of the market. It is the critical factor that accounts for much of the success of the Council's programs. Subsidies that provide shelter and protection from the market simply put off "doomsday" for business enterprises. Implicit in the Council's approach is the notion that program success also depends on access to capital. And the issue of capital access invariably leads to questions about the role of bankers in business development.

The role of bankers is frequently misunderstood. They are often asked by government planners and community groups to participate in local development in ways that simply cannot work. As a result, they either refuse to participate or their participation is very restricted. But this need not be the case. The solution is to ask financial institutions to do the one thing that they do best: make money.

The Council for Economic Action/Boston University/Boston Bankers Small Business Program helps program participants to approach bankers on acceptable terms, terms bankers understand. They learn, for example, how to prepare the business plan bankers expect to see when they are approached for a loan. The program permits the participating financial institutions to perform their appropriate roles and at the same time to become constructive partners in the development process.

Of the first 26 businesses started or expanded in Boston under the program, 80 per cent were minority businesses and 70 per cent were owned by women. Those businesses have created 65 permanent jobs. Capital financing for the businesses was $747 thousand, of which $426 thousand was provided by local banks, all at prevailing market rates.

Conclusion

There is an enormous reservoir of entrepreneurial energy for community economic development which can best be unleashed in an environment of regional growth. Entrepreneurial energy can be constructively guided through partnerships and other local economic initiatives to accelerate job creation.

A small number of individuals with technical experience, community entrepreneurship, and vision has made the difference in the revitalization of

Massachusetts. Those individuals succeeded because they worked together, and with banks and government programmers, in such a way that economic development could be amplified and accelerated. The role of community attitudes was crucial to the process. If communities are timid, if they fail to engage in entrepreneurial activities, they will not succeed. By contrast, no community entrepreneurial adventure has ever failed because of excessive boldness.

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Chapter 5

The Impact of Technology

Herbert I. Fusfeld

Technical advance plays an important role in creating jobs. At certain times, there is a direct and often dramatic relationship, such as in the growth of Apple Computer or Genentech. Most of the time, the result of technical advance is indirect and undramatic, as with the gradual improvements in making paper or textiles. Nevertheless, at all times, throughout all manufacturing and services, the number of people employed and the skills required by them are determined by the level of technology available and in use. This is just as true for McDonald's fast-food restaurants and Novotel as it is for Machines Bull and Rhone-Poulenc. Technical advance affects jobs in the stock market, the cinema, and department stores, just as it does in electronics, chemicals, and automobiles.

Technology Does Not Create Jobs

There is a paradox, a contradiction, in the way we approach the question of technical advancement and job creation. The introduction of technical change often results in the loss of jobs. The substitution of a new manufacturing process displaces workers in outmoded plants. Automation and computers replace industrial workers and clerical staff. Nevertheless, every developed country is exerting great efforts to generate and use technical advances, preferring the most advanced technologies which have can have the greatest impact on employment by reducing jobs.

Why do the industrialized countries encourage actions that may reduce employment? Obviously that is not their intent, nor are government leaders acting irrationally. If national policies are to result in economic growth, the operation of our economic systems, and the choices they present, must be examined.

The problem can be approached in terms of the old and the new. Familiar economic evaluations demonstrate the benefits of technical change. This analysis holds, first, that increased productivity lowers manufacturing costs and may increase sales of the products affected, thereby increasing employment; second, that new products represent new jobs that substitute for those lost in older product lines; third, that lower prices of products adds purchasing power for consumers, which increases sales of other products; and, finally, that increased economic activity provides more tax revenues for government which in turn can provide training programs, stimulate public initiatives, and increase worker benefits.

The question can also be approached in terms of the balance between the short-term and long-term effects of technical change. In the short-term, increased productivity and the growth of new products affect the specific industry or manufacturing process directly concerned. Gradually, the new technologies and products diffuse into other industries, representing a long-term, cumulative growth of potential for new jobs. Thus, the familiar explanation of industrialized countries' enthusiasm for technical advances which displace workers is that the jobs lost are more than equaled by the jobs eventually created in the applications of new technologies throughout all industries.

According to the Bureau of Labor Statistics, the introduction of technical advances has not resulted in a net loss of jobs.(1) Similarly, a recent study by the National Academy of Sciences concludes that "recent and prospective technological change will not produce significant increases in total unemployment".(2) But these statements do not seem to fit squarely into the picture of a vigorous economy in which high technology advances originating in industry, university, and government laboratories provide the foundation for the broad growth in employment that the United States has, in fact, experienced during the past ten to twenty years.

Technical Progress Creates Opportunities for Growth

What is wrong with the picture? The traditional economic analyses of costs, consumption, and productivity have focused on the relationship between technical advances and jobs. But a better perspective emerges if we consider the relationship between technical advances and the opportunities for economic growth. That perspective can provide insights into what has been happening in the United States, and into how differences between countries can affect this relation.

Technical advances do not create jobs, nor do they automatically create any physical product. Technical advances create opportunities for economic growth by providing options for investments - of time, money, and labor. Whether a specific advance results in jobs depends on the willingness and ability to invest, the areas selected for investment, and the way in which the process is managed. These factors are in turn influenced by government policies, economic conditions, cultural and social environment, and other investment options.

Two categories of opportunity for economic growth are identifiable: First are the opportunities offered by the system within which a technical advance emerges -- the classical activities of replacing product lines, improving manufacturing processes, and exploring new market applications. A critical factor in our ability to make the maximum economic use of a technical advance is the nature of the labor force -- the distribution of skills and mobility of people. The rapid growth of the U.S. semiconductor industry in the 1980s resulted largely from the availability of highly trained professionals who were willing to change jobs and locations.

Second, certain opportunities for economic growth do not flow directly from a specific technical advance, but arise from the level of technical sophistication that characterizes society. A technologically sophisticated society can accomodate a greater breadth of products and services than can one less technologically advanced, and growth opportunities increase as a society's technical level increases. For that reason, no developed country can afford to withdraw from the pursuit of technical advances. To do so might preserve some present jobs, but it would result in the loss of opportunities for broader economic growth.

The countries of the OECD are equal in their level of technical sophistication. Naturally, a large country can devote more people and more money to technical areas than can a small country. But scientists and engineers in Sweden or the Netherlands have access to the results of those studies also, and they are certainly qualified, from both the standpoint of education and competence, to put the information to use.

In principle, then, all the OECD countries possess similar opportunities for economic growth as a result of technical advance. There are certain advantages in being the leader in particular areas, but the minimum essential requirement is to develop the competence to absorb and build upon technical advances in the principal technical fields.

Taking Advantage of Opportunities

What has the United States done to develop jobs in a high technology society? The answer lies not in the technical advances *per se*, which are available to all countries that possess the requisite technical competence, but from what is done with the opportunities those advances present.

There are certain common threads in many of the experiences in the United States where economic growth has been based upon technical advances: interaction between scientists and engineers, a diffusion of technical advances quickly and easily, mobility and flexibility of professional technical people, the availability of capital in different forms to suit different functions, and a supply of technical entrepreneurs. These conditions have encouraged investments to introduce technical change into manufacturing processes, to develop markets for new products, and to start new businesses.

What mechanisms in the United States create these conditions?

First, there is a great deal of interaction between universities and industry. Corporations provide support to universities in order to attract graduates and to stimulate research in relevant fields. Increasingly, corporations participate in major long-term research programs which are often connected to National Science Foundation research centers or groups of corporations.

Second, small businesses and large corporations interact with one another. Employment growth has been in small businesses, but their success is often dependent on large corporations. The small business may be initiated to supply the large corporation as a quick way to exploit a new technology. Large corporations often provide research and development contracts to smaller firms. Such contracts have been a major factor in the growth of many biotechnology companies. In a number of cases, large corporations have provided venture capital or simply working capital in return for equity in smaller businesses.

Third, the United States enjoys a strong and creative base of venture capital. Venture capital exists in many forms and constitutes a source for exploiting technical advances at different stages. Large pools of funds can be assembled from modest investors, while investment banks and major venture capital corporations develop their own resources. Industrial corporations participate in this activity, as do research and development limited partnerships, and many states and local authorities.

Fourth, the United States has a strong tradition of encouraging entrepreneurs who convert technical advances to practical application by setting up new companies.(3) The possibility of great wealth facilitated by the tax system and encouragement from the investment community are major incentives. In the United States there is great esteem for entrepreneurs, even when they fail. The encouragement of technical entrepreneurs results in the rapid exploration of how best to exploit a new technology so that investments can be guided in the most rewarding direction.

Finally, regional economic development activity is a major driving force for job growth in the United States. Much of the recent focus has been on technology-based activity, but a detailed analysis shows a more complex picture.

Publicly, all the regions of the United States seem to be trying to become high-technology centers. In fact, what they want is to create jobs, but they want them to be in growth industries, which has often meant high-technology. It is indeed helpful, both for jobs and for image, when a region can develop a major technology-based activity, be it in the form of a large nucleus, such as a major research laboratory, or a cluster of activities, such as the defense electronics industry on Long Island.

The objective of either strategy is to bring into the region a critical mass of technical people. The presence of a large university encourages this, as does the presence of a technically-based corporation, which often provides a priority for the direction of growth.

Investment Based on Confidence

Regional development must be founded on the participation of all sectors and groups within the region: local government, industry, labor unions, banks, communication media, consumer groups -- everyone. The confidence that growth is taking place and will continue is the greatest possible encouragement for investment. The willingness to invest in applications for old or new industries suggests long-term growth. When that growth is identified with a region, investors have confidence in all the services and product opportunities associated with the level of technical sophistication that the region represents. Jobs are created by investments based on confidence, not by technology.

A very important factor in building confidence is the activity of regional authorities working with universities, industry and the investment community. That combination may be a unique strength of the United States.

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Chapter 6

Measuring Development Progress at State Level

Robert Friedman

In the struggle to overcome the human and economic damage caused by the last recession and to adapt to the rapid restructuring of the global economy, states have developed a new formula for creating and sustaining economic vitality. It is a formula which echoes many of the themes that were central to the founding of the nation and that spurred its rapid rise to international economic prominence: the entrepreneurial spirit, freedom of opportunity, belief in the individual and the community, investing in and building for the future, providing for an educated populace, building partnerships. This new formula is reshaping the economic landscape. The old formula for measuring the "business climate" of states is out of date.

Where the old formula pitted state against state in the competition to attract businesses, the new formula emphasizes strengthening the chief sources of new jobs and wealth -- the state's own existing businesses and potential entrepreneurs. Where the old formula was obsessed with cutting wages, benefits, regulations, and taxes, and with undermining unions, the new formula emphasizes investment to build international competitiveness. Where the old formula saw government as the enemy, the new formula sees government as a partner responsible for building the basic foundations of the economy.

But while States have revolutionized the business of "economic development", the means by which the vitality and attractiveness of states is rated -- indexes based on the old notion of "business climate" -- have not changed.

The Corporation for Enterprise Development has attempted to remedy the problem with its Development Report Card for the States.(1) The report card presents a new yardstick for measuring the economic health of each of the fifty states in the Union, and for exploring their ability to generate sustained and widely shared growth.

Why is a new index necessary? Because the old definition is irrelevant and destructive. It measures the cost of everything and the value of nothing. Winnng the struggle for economic competitiveness depends on getting the formula right. The entrepreneurs who stake their fortunes and their futures on an idea need to know where the idea is most likely to succeed. In a world of limited financial resources it is important to know what works, if only to avoid costly mistakes. The quality of people's lives is defined by the rate at which the economy expands and the extent to which the benefits of that expansion are widely and equitably shared.

Asking the Right Questions

Too many business executives, entrepreneurs, labor leaders, and government policymakers are not getting reliable guidance on the subject of economic development. Traditional measures of "business climate" routinely mismeasure and mislead.

In a worldwide economy where innovation, flexibility, resilience, and adaptability are the keys to business success, the strength of a state's economy, and the welfare of the people who make up that economy, depends on the ability to develop and make full use of the talents of those people. Economic strength also depends on the willingness to invest in and maintain the business and industrial infrastructure that forms the foundation of the economy, on long-term investments in education and research, on strengthening businesses, large and small, that already are a part of the economy, and on the development of partnerships between the private and public sectors. If a measure of what is "important to business success" in today's economy is sought, those are the factors which must be measured.

The Corporation for Enterprise Development decided to try its new approach in order to ask the right questions about economic development in the 50 States. The crucial questions are: (i) How well is the state's economy performing its job of providing people the opportunity for a better life? (ii) How vital are the businesses that compose the state's economy? (iii) What is the state's capacity for expanding growth and opportunity? (iv) What policies has the state established to help foster business growth and economic opportunity?

Those four factors -- performance, vitality, capacity and policies -- comprise the indexes that form the basis of the Development Report Card for the States.

The Performance Index

The first measure of whether a local economy is a good place for business to grow is its current performance -- that is, whether it is providing its people with real opportunities for a richer and better life. Business development is a means to this end, not an end in itself. It is astonishing that the traditional definition of "business climate" ignores this most fundamental measure of economic strength and attractiveness.

To measure a state's performance, the Development Report Card Performance Index incorporates five subindexes: The Employment category measures employment growth, the unemployment rate, the duration of unemployment, and the status of displaced workers. The Income category measures earned income per capita, per capita income change, and the percentage of people below the poverty line. The Job Quality category measures the number of working poor, hourly earnings, job-related deaths, and health coverage. The Equity category measures the distribution of income, black income as a percentage of white income, and AFDC benefits as a percentage of per capita income. The Quality of Life category measures crime, life expectancy, and infant mortality.

Perhaps not surprisingly, the New England states lead in the overall Performance Index rankings -- a reflection of the complex resurgence of the economies of the individual states in that booming region. More interesting is the strong showing of several heavily industrial states, including New York, New Jersey, Pennsylvania, and Delaware in the Mid-Atlantic region, and Minnesota and Wisconsin in the northern Great Lakes region. They provide strong evidence that a "Frostbelt" location can no longer be taken as synonymous with decline.

With very few exceptions, the Southern states are at the bottom of the overall performance ranking, the victims of a history of low-paying, footloose industries, the steady decline of agriculture, and the more recent decline of energy related industries. It is intriguing that the nation's industrial giants -- Michigan, Illinois, Ohio, and Indiana -- all have economies performing much better than many of the Sunbelt states, despite a lingering and erroneous public perception that the "Rustbelt" is still in the nation's economic basement.

The Business Vitality Index

No firm or industry can survive forever unchanged. In a rapidly changing, globally competitive economy, business survival depends on the ability constantly to seek and develop new products, services, production processes, and markets. Economic survival depends on the ability to generate new firms, to foster the expansion of young, small firms, and to encourage innovation in large, matute firms.

Three-quarters of all new jobs are being created by businesses starting up or expanding. The health of an economy is largely determined by the condition of businesses and entrepreneurs already within that economy. Documenting the competitiveness of existing firms and the extent to which new firms are being born helps to determine the vitality of a state's economy.

The Development Report Card Business Vitality Index includes two subindexes: The Competitiveness category measures international exports, manufacturing investment per production worker, percent of high growth companies, and the presence of Fortune 1000 corporation headquarters. The Entrepreneurial Energy category measures business formation rates, self-employment rates, and the number of businesses owned by minorities and women.

The highest overall ratings in the Business Vitality Index are held primarily by states that embody two characteristics: little or no history of reliance on older manufacturing industries, and a cultural predisposition to independence and self-employment. The leaders include Alaska, California, Arizona, Texas, and Colorado. These also tend to be states that have experienced recent rapid population growth, produce a high level of exports, and have relatively high levels of new business activity.

Predictably, many of the states that led the Performance Index also do well in the Business Vitality index. The top performance states -- Massachusetts, Connecticut, New Hampshire, Minnesota, Vermont, Washington, and California -- all score in the top twenty of the Vitality Index, showing that a mature economy can be a thriving one.

Once again, the Southern states lag behind the rest of the nation. Mississippi, Alabama, North and South Carolina, Arkansas, and Tennessee are at or near the bottom of the Vitality Index. These states, and states from other regions that are also near the bottom of the index, tend to have little industrial development, are poorly diversified, and in some cases rely extensively on agriculture.

Many states in the bottom quarter of the Vitality Index share another characteristic: they have been factory states, producing such items as automobiles, steel, and textiles for decades. With many people employed in a handful of large plants in one or two industrial sectors, their economies cannot capitalize on change -- they are vulnerable to it.

The Capacity Index

While the Performance and Business Vitality indexes measure the states' current economies, the Capacity Index assesses their potential for the future.

The Capacity Index measures two crucial components of economic development: the availability of the basic resources that feed and support the economy (an educated and skilled labor force, a range of capital resources, a well-developed physical infrastructure), and the aggressiveness with which these "economic nutrients" are being developed and used to strengthen the state economy. The traditional "business climate" definition is ironic, in that it penalizes the states which, by tax-supported capital budgets and education and training programs, provide for these needs, and it gives high grades to those states which do not.

The Capacity Index does not predict the future. It assesses the potential for economic success and the states' willingness to develop that potential. The Capacity Index incorporates four subindexes, each of which measures several key indicators: The Human Resource category takes into account, first, labor force skills and the quality of education in the state by measuring, for example, educational attainment, public expenditure per pupil, and pupil/teacher ratios. Second, it addresses technological innovation and the states' pool of innovators by measuring such indicators as scientists and engineers as a percentage of the workforce, science degrees awarded, patents issued, and university and federal spending for research and development. Finally, the Human Resource Capacity category assesses the entrepreneurial culture within the state.

The Capacity Index also includes: a Financial Resource category which identifies various types of loans, bank deposits, income per capita, and the number of venture capital firms within a state; an Infrastructure category which measures transportation systems, airports, and sewage treatment capacity; and an Amenities category which measures doctors per capita, arts appropriations, and foundation grant funds.

Analysis of the Capacity Index reveals that there is a direct relationship between a state's economic performance and its development capacity, particularly with respect to the education levels of its population. States that do well in one index virtually always do well in the other. States that are currently performing well have invested to ensure that they will continue to hold their leading positions in the future.

The Northeastern states, with their diversified, technology-enhanced economies, their history of substantial investment in education, and their high levels of wealth ("old money"), dominate the top positions in the Capacity Index. These states include Massachusetts, Connecticut, Rhode Island, New York, New Jersey, Pennsylvania, Vermont, and Delaware. Only the rural and somewhat remote state of Maine is not included among them. At the southern boundary, Maryland and Virginia are not far behind the leaders, and three other states with similar profiles, California, Colorado, and Minnesota, are also at or near the top.

The states with the poorest results in development capacity are, once again, most of the Southern states (Mississippi, Alabama, North and South Carolina, Arkansas, Kentucky, Tennessee, Georgia, and Louisiana), several thinly populated and relatively underdeveloped states (Maine, Nevada, West Virginia, Idaho, Utah, and South Dakota), and one major industrial state, Indiana. Indiana, despite its moderate showing on most other indexes has, in common with the Southern states, a history of low investment in education and, consequently, low educational attainment levels, low reseach and development capacity, poor venture capital and lending records, and a deteriorated infrastructure.

The Policies Index

During the last decade, there has been a quiet revolution in state economic development policymaking. State agencies that only a few years ago did little more than try to lure manufacturing plants away from other states today employ a comprehensive set of policy tools. They use those tools to spur entrepreneurship, to help improve the skills and adaptability of workers, to speed technological innovation, and to strengthen the competitiveness of home-grown businesses. Partnerships with private industry are an essential component of the strategy. State governments and private industry are working together to achieve economic development objectives that they are unable to achieve alone.

The Policies Index gathers over 30 state economic development policies and programs into seven categories: (i) improving governance and regulation; (ii) creating an effective and equitable tax code; (iii) mobilizing capital; (iv) enhancing technology and business development; (v) building and maintaining public works; (vi) investing in human resources; and (vii) helping distressed communities.

The Policies Index shows where the states stand in the process of economic restructuring and how aggressively each state is responding to the challenge. Surprisingly, the Policies Index does not show any significant political or ideological pattern to the responses states have made.

The Policies Index reveals several interesting details. It is no coincidence, for example, that the states wih the greatest number of initiatives in the Policies Index -- Massachusetts, Michigan, Minnesota, New York, New Jersey, Ohio, and Pennsylvania -- are the states that have suffered the most from the rapid and disruptive restructuring of America's industrial economy. In the absence of grand federal schemes, necessity has been the mother of invention. The pioneer, both in terms of disruption and response, has been Massachusetts, a state that was failing economically in the 1970s but which is leading today. Following in its footsteps, and benefitting from its experience, are the other industrial giants of the Northeast and the "Rustbelt" -- states both Republican and Democratic, liberal and conservative.

In the second tier of the Policies Index, in terms of the number and variety of development programs and policies in place, are two kinds of states: those determined to maintain their advantageous competitive position (for example, California, Florida, Maryland, and Connecticut), and those still seeking to grow (Maine and Vermont) and to build upon and share in the success of their neighbors.

Given the almost universally poor performances of most Southern states in the three other indexes of the Report Card, it might be reasonable to expect them to be at the bottom of the Policies Index. But that is not the case. The bottom of the Policies Index is dominated by the thinly populated and relatively undeveloped Mountain West and Northern Great Plains States, Wyoming, North and South Dakota, and Idaho, states with modest economies that, until the recent collapse of the farm sector, had been bypassed by the wholesale industrial restructuring experienced by more developed states. They have needed little in the way of development policy and they have done little.

The Southern states, on the other hand, appear to have grasped the situation. Faced with the diminishing returns from their long-standing industrial recruitment strategies, the South (with the possible exception of Alabama and Tennessee) is rebuilding. With the assistance of the Southern Growth Policies Board and its Commission on the Future of the South, Southern states are strengthening their government institutions, investing in educational reform, providing new support for indigenous businesses, and stressing the development and application of new technologies in both existing and new businesses.

In the South, and in all the states working to strengthen the competitiveness of their economies and their ability to produce expanding and shared opportunity, there is a clear hierarchy of initiatives. Educational reform is pre-eminent. Small business development and technology development are close behind. The mobilization of needed capital is unevenly pursued, reflecting in some cases the wealth of the state, and in others the willingness of state officials to become active capital market actors. Infrastructure improvements are often called for, but action is slow. Finally, efforts to bring distressed communities and the people who live in them back into the economic mainstream are very limited.

Conclusion

The lessons of the past show that states which invest in capacity-building can expect concrete progress toward expanding shared economic opportunity and creating attractive environments conducive to long-term economic growth. Enhancing the business climate does not mean reducing salaries, taxes, and benefits, or suppressing unions and regulation. It means investing in resources -- businesses, infrastructure, technology, and, most of all, people.

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Chapter 7

The Grand Illusion?

Irving Bluestone

On the face of it, the United States appears to be the most successful job creation machine in the world. President Reagan boasts that during his administration, employment increased by 13 million, approximately the same number as in the preceding eight years. Yet, interestingly, the rate of job creation under the Reagan administration has been lower than during the period of the Carter administration -- 1.72 per cent as against 3.3 per cent. But the raw figures reveal only part of the story. Closer examination discloses disquieting statistical undercurrents which portray a less cheerful picture.

European nations impressed by the surface figures of employment growth in the United States would do well to examine more detailed statistics and to ask themselves the following questions: What is the nature of the new jobs which have been created? What is their pay scale and their geographic distribution? Who are the employed and the unemployed? How many people are actually living in poverty? What is the current state of the national economy? How optimistic are the economic prospects for the future? How can government and the private sector maintain economic growth and well-paying jobs in a full employment society?

Disparities

Full employment, with everyone willing to work able to find meaningful jobs, continues to escape the U.S. economy. The U.S. Department of Labor's official figures (which do not include people who have dropped out of the workforce because they could not find work, or those who are underemployed but desire to have full-time jobs), indicate that the average rate of unemployment for succeeding national administrations beginning with President Truman has been rising. This includes the period of the Reagan administration, notwithstanding its years of sustained economic growth. The figures speak for themselves:(1)

Period of the Presidency	Average Official Rate of Unemployment	% Rise
Truman (1945-1952)	4.2%	
Eisenhower (1953-1960)	4.9%	+.7%
Kennedy-Johnson (1961-1968)	4.9%	
Nixon-Ford (1969-1976)	5.8%	+.9%
Carter (1977-1980)	6.5%	+.7%
Reagan (1981-1987)	8.1%	+1.6%

Source: U.S. Bureau of Labor Statistics.

The steepest increase in the average rate of unemployment, 1.6%, covers the years of the Reagan administration.

The national statistics are particularly worrisome in light of the disparities that exist among various sectors of the population. The unemployment rate for teenagers in November 1987 was 14.3 per cent -- for black teenagers it was 34.3 per cent. The overall jobless rate for black workers was 12.1 per cent, for Hispanic workers 9.1 per cent, and for white workers 5.1 per cent. For the city of Detroit, heavily dependent on the automobile industry, the figures are even more troubling: 24 per cent of black workers, 57.1 per cent of black teenagers and 7.5 per cent of white workers are jobless.(2)

Indebtedness

The high levels of consumption which have spurred economic growth have largely been maintained by increases in private and public indebtedness. Consumer debt has reached new highs. Farm debt has skyrocketed, resulting in a rising rate of farm bankruptcies. Similarly, corporate debt has risen from an average of 32 per cent of corporate earnings in the 1970s to over 50 per cent in the 1980s.(3) And, of course, the most glaring publicity has attached to the federal debt which currently exceeds $2 trillion and continues to rise. The coming generation will be saddled with debt and service costs to an extent never before experienced in the history of the country.

Economic Growth

While the economy has continued to expand, the rate of growth has slackened. In the 1960s, the annual average increase in GNP was 5.0 per cent. In the 1970s it receded to an average of 3.5 per cent, and the prospects for sharp reversal of this trend in the remaining period of the 1980s are not promising.(4) The utilization of industrial capacity has also declined, from 91 per cent in 1966 to 82 per cent on average thus far in the 1980s.(5) Deindustrialization, particularly in key industries such as automobiles, steel, and telecommunications, has become a key feature of the national scene, with a steady shift from manufacturing to service sector jobs.

Decline in Living Standards

Following World War II, the United States dominated the global economy, and Americans' standard of living rose markedly. For the last decade or so, however, the real income of the average American household has been essentially stagnant and is now below the peak achieved in 1973. Income disparities between high and low have widened, and the middle class, the stable underpinning of the economy, has been shrinking. Thus, median family income in 1973 was $29,169 in 1985 dollars. By 1985, it had declined to $27,735(6) -- a fact leading, no doubt, to the low savings rate and the high rate of consumer borrowing and debt.

Poverty

Poverty in the United States is rising. The poverty line for a family of four as established by the U.S. Government was $11,203 per year in 1986. About 15 per cent of all households (approximately 33 million people) are currently below the poverty line, up one third since 1979.(7) Of course, those households with incomes barely above the poverty line are not much better off.

The gap between the "haves" and the "have nots" in U.S. society has been widening, accelerating the trend toward economic inequality. The latest analysis of wealth distribution indicates that 10 per cent of U.S. families owns 86 per cent of the nation's net real assets, while the remaining 90 per cent of families owns 14 per cent. Indeed, 2 per cent of families owns 54 per cent of the net real assets of the country, with "unearned income" rising faster than earned income.(8)

Newly Created Jobs at Lower Pay

Recent studies have established that most of the jobs created in the past decade fall into the category of low-paid employment. The net growth in the "Great American Job Machine" has been in the "service" industries, while manufacturing industries have lost more than 2 million jobs since 1979. Average earnings in the industries in which employment is declining are $402 a week, while average earnings in the industries of employment growth are $258 a week.(9) The growth in new jobs expressed in raw statistics paints a far brighter picture than is warranted by an examination of the nature, quality, and pay scale of those jobs. This is a point too often ignored in the attempt to make political capital out of the job growth issue. It also explains in some measure the growing number of part-time workers and of two-earner families since, increasingly, it requires more than one income to keep a family afloat.

The Need for a Long-Term View

The litany of troubling economic statistics has led a growing cadre of economists to assert that the younger generation of Americans cannot look forward to an improvement in their economic status compared to that of their parents. Should this prediction prove to be true, it will be without precedent in the history of the nation.

It is evident that a broader, long-term national vision is called for in developing strategies for the future wellbeing of the nation. Neither centralized economic planning nor unfettered laissez-faire economics is the solution. It is becoming more and more evident that interaction between national strategies and the state, community, and private sector levels provides the impetus for creating jobs and assuring a better life for the people.

Strategies

It is vital to improve primary and secondary education, and to provide continuing education opportunities throughout workers' lives, with emphasis on retraining to accommodate to changing work requirements. It is estimated that approximately 20 per cent of the U.S. workforce is functionally illiterate, in this era of technological advancement which often requires increasingly sophisticated skills. In the United States, the quality of education is too dependent on individual community income, with resulting wide disparities in expenditure per pupil, and sharp community and regional differences in the quality of educational training and infrastructure. Federal financing policies are needed, policies which would help alleviate the disparities while leaving administrative control at the local level. Special allocations for job training and retraining would help to convert old skills to meet new skill requirements.

Public buildings, roads, bridges, dams, harbors, water supplies, and waste treatment facilities are quickly deteriorating and must be repaired, restored, or rebuilt. Many jobs for a properly trained workforce will become available as national, state, and local programs are developed to assure an orderly restoration of the nation's infrastructure and an improvement in the quality of life.

The United States devotes less to research and development, as a percentage of GNP, than its major trading partners. Federal government funding of university research is declining at a time when other countries are increasing their expenditures as well as their pool of scientists and engineers. Research expenditures by the federal government, working in concert with universities and farmers, created an agricultural economy in the United States second to none. A similar national policy is needed in which the federal government, the private sector, and the universities engage in coordinated efforts to assure that progress in research will meet the needs of the next century.

Priority to Small and Medium-Sized Business

National, state, and local government should assist small and medium-sized firms because it is there, not in the giant companies, that the greatest number of jobs is being created. Governments could, for example, help create trade associations designed to facilitate cooperation in pursuing technological innovation, and provide advice or even loans to potential entrepreneurs, especially in areas sorely in need of employment possibilities.

In Michigan, for instance, a percentage of state pension funds is used for such purposes, and the Michigan Strategic Fund provides start-up loans to promising enterprises. At the state level, offices are established to assist small firms in developing bids for national government contracts, military and civilian. The Michigan Modernization Extension Service provides information and assistance to small and medium-sized businesses about the available technology and its proper use and cost. Providing friendly assistance to create and sustain small and medium-sized businesses is proving to be a sound investment in job creation.

Labor/Management Joint Action

The development of joint action programs between management and labor is accelerating. Area labor/management committees are endeavoring to create and retain jobs for their communities. Statewide labor/management activities, some privately initiated, others under public sponsorship, are undertaken to create a more congenial labor/management atmosphere and to establish a job-creating business climate. Such an organization, the Economic Alliance for Michigan, was created in 1982 by concerned business executives and labor representatives as a non-profit, free-standing, private sector labor/management alliance. In other states (Ohio, Pennsylvania, New York, and Indiana, for instance), the state government has organized similar structures aimed at improving the business climate and developing programs to enhance the economic and social condition of the community by cooperative efforts.

With the help of national legislation to encourage the establishment of employee stock ownership plans (ESOPs), efforts are under way to promote employee takeovers of companies that might otherwise shut down. Approximately 8 000 ESOPs currently exist in the United States, although only a small number fall into the category of majority or 100 per cent employee ownership. Unfortunately, some firms take undue advantage of the tax benefits which the ESOP law permits without affording the employees a voice in managing the enterprise, and even by substituting stock ownership for a much needed pension plan.

The Economic Alliance for Michigan

The Economic Alliance for Michigan represents a successful labor/management collaboration. The Alliance is a statewide labor/management organization with offices in Detroit and Lansing, the state capital. It is financed by annual contributions from its affiliated businesses and labor unions, and has a small, effective staff. Its membership is voluntary, and is composed of chief executive officers of firms throughout the state and elected labor representatives from the state AFL-CIO and other unions with membership in Michigan. The Alliance is co-chaired by a business and a labor representative elected by the executive board, on which every Alliance affiliate is represented. Since closely split votes reflecting sharp differences of opinion could immobilize the organization, any action undertaken by the Alliance requires a 75 per cent affirmative vote by the executive board. To date, the Alliance has won the necessary 75 per cent vote on all issues.

Each year, the Alliance solicits recommendations from its affiliates on where to focus its activities. The executive board discusses the recommendations and establishes priorities. Task forces are created, with membership generally equally divided between management and labor. The affiliated business and labor organizations provide professional and technical assistance. Occasionally, the parties arrange for special studies to be undertaken by outside research organizations on subjects under consideration. Each task force studies its assigned subject, collects pertinent data, and attempts to arrive at a consensus recommendation to bring to the executive board. The board debates the task force recommendation and then votes.

The Work of the Alliance

For the most part, the Alliance has addressed problems requiring legislative solutions. For example, because of the tens of thousands of unemployment compensation claims that had to be paid to laid-off employees during the recession, when unemployment in the state peaked at 17.2 per cent, Michigan's unemployment insurance fund was exhausted. The state had borrowed heavily from the federal government to maintain its fund, generally at 10 per cent interest. It was evident that legislative measures had to be taken to protect the solvency of the fund. Accordingly, the Alliance set out to solve the problem of how to keep the fund solvent while enabling the state to continue to fulfill its statutory obligation to dispense benefits to unemployed workers. It submitted to the legislature a proposal which included temporary benefit reductions, stricter elegibility criteria, and a restructuring of business's contributions to the fund. The legislature unanimously adopted a bill which incorporated the Alliance's proposals, and Michigan was thus able to restore its unemployment insurance fund to health, to continue to pay benefits, and even to repay its federal loans.

The Alliance also chose health care cost containment as a major issue for its attention. The United States continues to lag behind the rest of the industrialized world in providing health care benefits as a matter of right, except for the elderly and disabled. Although most firms in the private sector, and the government, provide some measure of medical insurance for their employees, health insurance is generally privately maintained. Health care cost inflation has been accelerating at a rate considerably higher than the average national rate of inflation. In 1986 it was more than six times higher. To address this problem, the Alliance submitted a proposal, ultimately adopted by the Michigan legislature, which promoted the establishment of alternative health care provider organizations involving hospitals, doctors, and pharmacies offering high quality pre-paid health care at lower cost. Such programs continue to proliferate throughout the state as more and more employees and their families take them up. Thus, health care cost inflation has been curtailed while benefits to the employees and their families have been retained and even improved.

Partnership and Job Creation

Several states have established joint labor/management organizations designed to enhance economic development, and to create and retain jobs. In many communities, private sector, non-profit economic development corporations, such as the Detroit Economic Growth Corporation, have been organized. These groups, supported by private, state, and local financial assistance, promote entrepreneurship in their communities in order to create new job opportunities.

Many communities have established area labor/management councils (ALMCs), cooperative efforts aimed at bringing businesses and jobs to their areas. The ALMCs hold conferences, provide training programs, and offer orientation courses in the effective administration of human resource management. In some instances, ALMCs involve themselves in local collective bargaining disputes.

While such development in cooperative activity between labor and management are by no means universal, they are increasing, particularly in states and communities where union/management relations are long-standing and where they have become significant factors in the state or local economy. Regrettably, in other regions of the country an increase in anti-labor activity by employers has generated sharp controversy between management and unions, and has effectively blocked opportunities for joint activity. Essentially, labor relations is travelling along two parallel tracks -- one leading to mutual problem-solving in areas of common interest, the other destined to inflame controversy in an adversarial climate. The future will determine which course will dominate the industrial relations scene. The evidence is clear, however, that greater progress will be made when labor and management, while recognizing their differences, concurrently seek out the many interests they have in common to their mutual advantage and to the ultimate benefit of the whole of society.

Human Resource Development

In the final analysis, the economic success or failure of the nation will depend on the effective utilization of its human resources. Every effort must be made to provide the means to unleash the full capabilities of every citizen to be creative, innovative, and imaginative in the management of government, of enterprises, and of the workplace. This requires the development of a different internal culture in organizations. It requires a departure from the authoritarian control of the workplace, the introduction of more democratic values in decision-making, and more enlightened managerial practices. The participative management approach is evolving in many countries, elevating the quality of work life for employees, and enhancing the probability of success for the organization. It is, after all, educated, trained, intelligent people with a new vision of the future who will create and sustain viable economies.

Mr. Bluestone is the Director of the Institute of Labor Studies at Wayne State University in Detroit, Michigan, and the former Vice-President of the Union of United Auto Workers.

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PART III.

PARTNERSHIPS AMONG PUBLIC AUTHORITIES AND THE BUSINESS COMMUNITY

Chapter 8

Introduction to Part III:

For the Good of One and All

Partnerships between local elected representatives and economic decisionmakers are an important feature of American job creation initiatives. Particularly interesting is that such partnerships have developed in a traditionally non-interventionist country.

State governors cite industrial decline, unemployment, over-dependence on single industries, and the need for job training as the primary reasons for their increasing intervention in economic development. To those reasons may be added the federal disengagement brought about by the 1981 Program for Economic Recovery, which resulted, for example, in a nearly 50 per cent decrease in the budget of the Small Business Administration between 1982 and 1986, and the contraction of the Economic Development Administration which had been set up in the early 1960s to promote development in depressed areas. The governors were thus often obliged to intervene. Finally, the failure of American banks to finance small and medium-sized enterprises prompted cities and states to intervene in economic development.

Intervention in economic development by local governments is facilitated in the United States by the flexibility of the legal framework and by the wide latitude allowed to local authorities under the federal system. Owing partly to local taxation and partly to the possibility of issuing bonds, local authorities have access to far greater resources than their French counterparts. Industrial revenue bonds and municipal bonds find subscribers among pension funds, insurance companies, banks, and the general public.

There are in the United States powerful mayors and governors who are very motivated and involved in economic issues. The Governor of Massachusetts, Michael Dukakis, illustrates this American phenomen.

Very Different Local Situations

The increase in interventionism and the growth of local partnerships are unevenly distributed among the cities and regions of the United States.

Governor Dukakis is not representative of all American governors. The regeneration of Philadelphia and Baltimore, described in Chapters 11 and 12 by Messrs. Widner and Berkowitz, has not been duplicated in all American cities, nor has the action taken by the State of Massachusetts on education, discussed in Chapter 9 by Ms. Stratton, or the State of Michigan on industrial modernisation, discussed in Chapter 10 by Mr. Plastrik. They are an experimental elite and should not be used to generalize about all American cities and states.

The size of the United States complicates any comparison with French or European local government intervention. The budget of the 22 French regions is FF 17 billion, whereas the State of California alone administers nearly $40 billion. Boulogne-sur-Mer has been compared to Philadelphia and Baltimore insofar as they are port cities with similar industrial histories and economic problems. But Greater Philadelphia has a population of 5.7 million and the Baltimore conurbation 2.5 million. In the Boulogne-sur-Mer area, the population is 80 000. Thus, French elected representatives must avoid mechanical comparisons with the American experience. The lessons to be drawn have to do with approach, mentality, and method.

Partnerships with Specific Goals

American partnerships are usually created for a specific goal. They tend not to be institutional. The partners meet because they have concrete targets and concrete roles to play. In Chapter 9, Ms. Stratton emphasizes that the projects instituted by partnerships benefit the partners individually as much as they benefit the community generally. Partners seem to be mobilized by the quest for both joint and individual involvement.

In French local partnership structures, by contrast, the partners are usually individuals appointed on the basis of their ability to advance their organization's point of view, not on the basis of their ability to contribute to specific projects. When that occurs, whatever they achieve tends to represent the "lowest common denominator" -- a compromise which is less than the total of the partners' combined energies and which amounts to very little. In other local development structures, mixed syndicates, mixed economy companies or even limited liability companies, all of which are commonly found in Europe, it is too often the case that some local partners take part only because they believe that they have no other choice. They put little, least of all faith, in the project. The result is that certain committees consist only of sleeping partners or, worse still, formal members whose presence impairs the project.

Predominance of Private Values and Methods

Private sector values, targets, and procedures predominate in American partnerships. The definition of roles and the distribution of tasks are clear: economic development is implemented by private firms; the role of local government is to create a favourable business environment which includes a desirable quality of life, intelligent planning, and financial support.

Johns Hopkins University's business and research park in Baltimore, discussed in Chapter 12, associates city, hospital, university, and private business, and illustrates the way private sector values and methods are applied in a university/business/community partnership. It is a feature which differentiates the American partnership quite sharply from the mixed economy types found in Europe and helps to explain why a number of the obstacles observed in France are less prevalent in the United States. How many French universities still prefer to keep research under wraps up rather than see it "go private"?

While the predominance of private entrepreneurial values may have certain negative effects, it no doubt obliges partnerships to produce tangible results. The activities launched are often initially experimental: if they work, they are pursued; if they don't work, they are stopped or altered. Accordingly, American partnerships consistently evaluate the results of their programs. Evaluation is a practice frequently missing in the French public sector, which is often more interested in compliance with administrative procedures than with assessing the value of its activities.

An Assured Professionalism

Perhaps because of their entrepreneurial values and methods, American partnerships reflect a high degree of professionalism. For example, American cities and states have mastered the tools of financial practice. Sometimes they employ "financial packagers" who are capable of identifying needs, finding sources of finance, and setting up venture capital funds. Often, French and American programs differ more in their methodology than in what they undertake to do. The question of the qualifications of French and European local government officials has become important. They are indeed qualified in many ways, but how wide is their economic experience? Are they capable of diagnosing the business needs of their local communities, and mounting operations to address those needs? Can they competently administer the business projects presented to them?

In conclusion, to the extent that American partnerships between elected representatives and economic decisionmakers exist in a different cultural context and are supported by different resources, they cannot be adopted wholesale as blueprints by other countries. But they do point out certain directions that could be followed, and features that should be explored, such as entrepreneurism, strong political leadership, a high degree of professionalism, and the emphasis on evaluation and results.

Hugues Sibille

Chapter 9

Why Partnerships? Massachusetts' Experience

Catherine Stratton

A partnership is a collaboration among business, non-profit organisations, and government in which risks, resources, and skills are shared in projects that benefit each partner as well as the community.

The rationale for partnership is simple: it is to produce benefits, through collaboration, that the partners could not produce alone. It is a self-interested activity, a means of making the most effective use of limited resources to meet institutional and community needs.

It is important to emphasize what partnership is not. It is not philanthropy or privatization. It is not a conventional contract relationship, which is essentially a straightforward business proposition, nor is it a simple grant or subsidy in which there is no cross-sectoral collaboration. For a partnership to work, there must be a close match between the interests, skills, and resources that each party can contribute, with those needed to solve the problem.

Human Resources Come First

More than it depends on the availability of capital, physical plant improvement, or enlightened tax or regulatory policy, economic prosperity today depends upon the existence of a competent, flexible labor force. Such a labor force requires the poor and unemployed to be brought in from the margins to the economic mainstream, and it requires the skills of our current workers to be maintained. Joint programs must be established to help young people move easily from school to work, to train the long-term unemployed for skill-shortage occupations, and continually to retrain and upgrade today's workers for tomorrow's technologies.

As the ultimate consumer, and certainly the major market for its graduates, business must be a full partner in the planning, design, financing, and general oversight of training and employment programs. The central question is not whether employers should become involved but how to engage them in a substantive way. What process can be used to infuse business into the public decisionmaking process? Equally important, what policy, program and institutional changes are necessary to attract the support and sustain the interest of the corporate community?

These were the key issues facing Massachusetts policymakers when they were directed by Governor Dukakis to overhaul the State's training and employment system. A system which, when the overhaul began in 1984, was failing miserably.

Restructuring Training Programs

When the restructuring began, Massachusetts had a chaotic patchwork of programs, with no coherent policy framework to promote full employment or economic growth. The State had more than twenty programs administered by more than a dozen agencies, all with different goals, eligibility criteria, administrative protocols, and local delivery systems. To the consumer, job seeker, or employer, it was not a system but an intimidating maze of programs and services in which people became lost and confused. Equally problematic, the job-training network operated in relative isolation, unconnected to the State's economic development or education systems.

The policymakers examined the issues and concluded that simply reshuffling organizational boxes was not the answer. Nor would the problem be solved by launching a new, quick-fix, high-profile placement program for the unemployed. Indeed, too many of Massachusetts' programs reflected more concern for the "register effect" than for attaining true economic self-sufficiency for the individual, or developing a skilled labor pool for Massachusetts employers. It was time to take a fresh, long-term approach, one that transcended institutional boundaries and embraced all the education, training, employment, and support services needed to build a productive workforce.

Six major principles guided the restructuring of the Massachusetts training and employment system: (i) integration with economic development; (ii) flexible, comprehensive services; (iii) open access; (iv) improved programs; (v) streamlined administration; and (vi) decentralized management.

i) Integration with Economic Development

Education and training programs were to be central components of economic policy, with the ultimate objective of helping to create full employment in the State. Although Massachusetts' training programs had to continue to serve their historical function as a means to achieving important social objectives, (such as equal employment opportunity, improved basic skills, and economic self-sufficiency), it was imperative that far greater attention be given to job training as a fundamentally economic function, that it be viewed as a critical source of skilled workers. Strategically managed training programs could stimulate employer investment and job creation, and could mean the difference between economic growth and stagnation, particularly in the State's depressed regions.

ii) Flexible, Comprehensive Services

The new system was to be easily accessible, offering multiple options and real choices for the individual. Meeting this objective required creating a smooth sequence of activities, a continuum beginning with literacy and new language skills, entry-level vocational training, upgrading and retraining, through to advanced technical and professional education, accompanied by measures to help people move easily from one step to the next. It also required drawing on the resources of all public and private institutions: local secondary and vocational schools, colleges and universities, and the myriad of education and training programs provided by state and non-profit agencies.

iii) Open Access

The policymakers sought to open the system to every resident who faced occupational barriers, regardless of income or employment status. Unlike most educational institutions and the state employment service, the job training system traditionally has been narrowly targeted to the poorest people, which stigmatizes its graduates and leaves many without help. A flexible system provides upgrading for workers in dead-end jobs, and retraining for those with obsolete skills. This did not mean eliminating goals or service priorities, but rather targeting job training by its content, not by the income of its students. The policymakers believed that few affluent people would demand adult literacy programs, English-as-a-second-language training, entry-level vocational education, or technical retraining. Moreover, they knew that few employers would wish to be partners in a system they perceived as no more than a last resort for the disenfranchised.

iv) Improved Programs

The policymakers wanted to improve greatly the quality of their programs and to build a performance-based system that would be publicly accountable for its product and genuinely valued by the business community. To do so required selecting providers -- whether employers, unions, non-profit enterprises, or government agencies -- on the basis of documented value-for-money, and paying them only after they had achieved the desired objectives. This policy came as a considerable shock to some of Massachusetts' traditional contractors.

v) Streamlined Administration

If programs were to be operated efficiently and effectively, major changes were required in the arcane administrative systems that threatened to overwhelm even the most skilled local managers. The red tape that bound the hands of local managers symbolized to business the very worst of government inefficiency.

vi) Decentralized Management

Labor markets are essentially regional. The demand for workers, the types of employers, the population to be served and the available resources vary substantially in different areas of the state. If the system was to be sufficiently flexible to respond to diverse political, social, economic, and institutional needs, it had to be planned and managed at the local level. Within the state government, decentralized management was perhaps the most controversial of the policymakers' guiding principles.

Putting Theory into Practice

The six guiding principles discussed above provided the theoretical framework for Massachusetts' proposed employment training system. But how were these policies to be translated into practice? How could the business community be induced to become a major stakeholder in planning and overseeing the preparation of its own workforce?

Rather than developing a new organizational structure, Massachusetts built upon a public/private partnership which had been established as part of national job training legislation enacted in 1983. Under this legislation, Private Industry Councils (PICs) were created to monitor the local spending of federal training funds. At least 51 per cent of council membership is required to be from the private sector, with the balance of membership from labor, economic development, education, and voluntary organizations.

The legislation creates a delicate balance of power between the PIC and the local authority by requiring the Council and the mayor (or county official) to agree, by contract, on who will receive the funds and who will administer the program. The Council's primary responsibility is to develop and administer an annual labor market plan that determines which population groups will be served, the kinds of training to be offered, the allocation of finance to each activity, and the performance results that contractors must achieve. Before any money is spent, the plan must be approved by the local elected official. In this way, public accountability is assured and a careful balance of interests is maintained within the partnership.

As part of the State's reform, the mission and powers of the PIC were greatly expanded, and it was given increased stature by being codified into state law. The new partnership was charged with creating a comprehensive employment and training plan that coordinated all the education, training, economic development, and human services in the region. It was to design a delivery system which would address everything that people needed to secure and maintain employment, including literacy, skills training, counselling, child care, housing, and transportation.

The partnership was also intended to monitor the quality of the programs to insure that they met the needs and standards of business for dependable workers, appropriately trained and readily available.

What Have We Learned?

After four years of hard work, the record of the fifteen partnerships created in Massachusetts is mixed. Some have enjoyed spectacular success and have become national models. More have become solid, working enterprises, gradually building their competence and capacity as regional labor market boards acting in close cooperation with their elected officials. A few were disasters -- pro forma groups lacking any influence or credibility within their community.

What distinguishes the strongest partnerhips from those that exist only in name? There appear to be five factors that are crucial to the success of public/private relationships. They may be called the five "M"s: (i) Membership, (ii) Mission, (iii) Money, (iv) Management, and (v) Measurable results.

(i) Membership

Councils must have top-level representatives from both the public and private sectors. Those representatives must be chief executive officers with the authority to make decisions, and the political and economic influence to effect institutional change in such diverse areas as school reform and vocational education, child care, and economic development. Massachusetts learned this lesson at some cost: when the State approved second-tier management or personnel officers, the Council lost the prestige and power to act as an equal partner with elected officials. Such a council may have dedicated membership, but it is unlikely to have any real influence within the business community.

(ii) Mission

The partnership must have a broad charter, and a bold vision that extends beyond the bounds of job training. Chief executives will lose interest if they are simply deciding whether to focus on welding or clerical training. Issues must go to the heart of their economic and social environment, to the quality of life in the community.

Educational reform, economic development, housing, and transportation issues are inextricably linked to those of employment and productivity, and should be an integral part of the partnership's agenda.

(iii) Money

Successful partnerships require sufficient investment at each stage of the project, including seed money for planning and an adequate operating budget. Although it is important that all parties contribute to the venture, private funds are especially valuable since they permit the flexibility which public funding often cannot provide.

The most successful PICs have diversified their financial base by raising corporate or foundation funds to support higher risk or innovative programs, and to help leverage change within public institutions. Those that rely exclusively on public finance are perceived to have little independence, to be captives, or at best the passive handmaidens of local government.

(iv) Management

Public/private partnerships demand at least the same energy and attention that any other business or government enterprise needs. This requires recruiting highly competent staff who enjoy the confidence of both the mayor and Council members, and who can take charge of the mechanics of the operation. It also requires creating an information system that is open, timely, and reliable. New partnerships are delicate structures which frequently involve interest groups with little history of cooperation.

(v) Measurable Results

It is crucial that the partnership's objectives are clearly defined in measurable terms, that each party is held accountable, and that return on investment is assessed at regular intervals. Within Massachusetts' employment and training system, the state sets performance standards for placement rates, entry wages, and unit costs for placement. Each local partnership must report annually on its performance. There are financial rewards for those that excel, and administrative sanctions for those that consistently fail to achieve their goal.

Barriers to Creating Public/Private Partnerships

Using partnerships to provide public services may require fundamental behavioral and structural institutional change. No matter how enthusiastic and committed government may be, it is not, by nature, a good partner. The public sector is generally organized for the convenience of the bureaucrat, not the user. Public services are compartmentalized into isolated baronies that deliver single products or perform only their own activities.

Partnerships, on the other hand, demand flexibility, accessibility, and integrated programming. If government is serious about using partnerships to deliver services, public administrators must alter the way they plan and organize their work and, perhaps more important, the way the perceive their own roles.

To become effective partners, public officials must be less regulators and more entrepreneurs. They must design programs from the outside in -- from the standpoint of the consumer, not of the producer. They must conceive packages of services that meet all of the consumer's needs, that are not merely discrete products reflecting the self-contained boxes on an organizational chart.

The natural inclination of bureaucracies is towards organizational symmetry, uniformity, and internal consistency -- "institutional tidiness". But partnerships are not neat: they are complex and fragile, and they take time to mature. They must reflect the political, social, and economic character of the community. They can be nurtured, but never mandated, by state or federal government. No two partnerships will ever look exactly alike. They cannot be molded or standardized to fit government regulations -- their individuality is their essential strength.

If local partnerships are to be used in any ongoing capacity, central government must be willing to make a serious, sustained investment in them. More problematic, it must tolerate the prolonged evolution of volatile, idiosyncratic entities over which it has relatively little control -- very difficult for public administrators accustomed to a centralized, top-down mode of operation.

A further barrier to the creation of local public/private partnerships is the difficulty of sharing power. Centralized state bureaucracies may be reluctant to cede decisionmaking authority to mayors and Private Industry Councils. But partnerships are built from the ground up. They are formed at the local level where the interests of business and government are most sharply defined. They can only thrive if the shareholders have significant control over their investment -- that is, if local business, community, and political leaders are free to use resources in the way they judge will best solve the problem.

Inevitably, some of those resources will come from federal and state government. If those governments are unwilling to relinquish some degree of control, they will stifle the initiative of the local partners and, ultimately, they will emasculate the partnership. This is not to suggest that public funds should be converted into unrestricted grants. Federal and state government should set clear program objectives and rigorous performance standards for recipients.

The Roles of the Partners

Federal and state government can play an important role in partnerships by creating an environment conducive to their formation. Government leaders must be advocates for greater business involvement. They should publicize successful models and establish avenues for information exchange among communities. They can provide technical assistance and they can even help negotiate deals. What they cannot do well is design and manage working partnerships. That must be left to the communities.

Business has much to offer to partnerships: managerial and technical expertise, personnel, flexible resources, and fresh ideas and innovative strategies for solving intractable public problems.

Conclusion

A good partnership can be a powerful catalyst for change and a convenient vehicle for building community consensus around the issues of education, employment, and job creation. But partnerships must be nurtured by leaders, public and private, who are willing to take individual and collective risks and who are courageous enough to stretch beyond conventional practice. Otherwise, as so aptly stated by General Motors President, Roger Smith, "If you do the thing you've always done, you'll get the thing you've always got."

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Chapter 10

Economic Development in Michigan

Peter Plastrik

Michigan is the birthplace of the American automotive industry. There, eighty years ago, Henry Ford launched his vision of a mass market for mass-produced vehicles. Because of his innovation, Michigan became the center of auto production and enjoyed half a century of above average prosperity. Until the 1980s, per capita income in the State exceeded the U.S. average by as much as 10 per cent.

Michigan is the heart of American progressive trade unionism, championed by the United Auto Workers, a leader in industrial unionization and the civil rights movement. By social tradition Michigan is the "arsenal of democracy", where working people rapidly transformed factories into weapons suppliers for American and European forces in the Second World War.

Michigan is the home of Detroit, among the nation's ten largest cities, with a population of one million. It is probably the largest black-majority city in the United States.

Michigan's recent success story is different from those of other states, which have tended to enjoy high-technology, small business successes. Unlike Massachusetts, for example, Michigan's prosperity has not depended on federal defense spending or on the computer chip revolution to build a new industrial base. Michigan is not a center of university entrepreneurship, nor has it developed a small business exporting culture.

Job Creation

In 1983, Michigan's unemployment rate was 17 per cent, whereas it is now 8 per cent. Net job creation since 1983 has been 520 000 jobs, mostly in the service sector. One of Michigan's development strategies has been to emphasize advanced manufacturing which depends on automation and computerization. As a result, a business sector has developed to provide services to the computerized factories.

In spite of the general decline in manufacturing employment, there are several manufacturing sectors in Michigan that have enjoyed job growth. The most notable among these is the automation supply sector, which has 33 000 jobs distributed among 325 small companies.

In the past, Michigan tried to compete with its border states to induce businesses to come to the state by offering lower costs of doing business. But companies that respond to such incentives are not the kind of companies Michigan now seeks - such companies will, ultimately, emigrate overseas to even less costly locations. Michigan seeks companies that can compete internationally, companies that produce quality jobs for Michigan's workers.

The Path to a Development Strategy

To devise a development strategy, policymakers must begin by asking: How does the government figure out what it wants to do? Especially needed for this phase of development are intelligence and clarity of purpose. In pursuing its path to a development strategy, Michigan undertook seven distinguishable steps:

a) Analyze Conditions: In 1983, when Governor Blanchard took office policymakers knew certain facts about Michigan: unemployment was 17 per cent, the state treasury was empty, public psychology was depressed, and the federal government was doing nothing to help. But little was known about the condition of or prospects for the Michigan economy or the automobile industry, the State's principal economic engine. Attention was focused almost entirely on the Fortune 500 companies located there, even though the State had 10 000 small manufacturers, and most new employment was not being created by the large industrial companies. There was a popular belief that Michigan had a highly skilled workforce, but the belief had never been analyzed. Little was understood about the globalization of markets and production and its potential impact on the State.

Consequently, Michigan organized an unprecedented, sixteen-month analysis of the state economy. The analysis focused on the structural pressures and changes in the economy, rather than on its cyclical behavior.

The analysis revealed that manufacturing matters a great deal to Michigan's present and future prosperity, as it accounts for more than 40 per cent of yearly Gross State Product. It also identified a significant comparative advantage that could be gained by supporting the growth of advanced manufacturing industries. And it revealed, for the first time, that although Michigan industries had been losing their share of national production, many of those industries had grown during the preceding ten years.

b) Evaluate Public and Private Assets: Examination of Michigan's asset base showed that businesses had different goals and needs, depending on their size. Different sectors showed varying characteristics, as did failing and successful companies. Research universities differ in purpose and capacity from community colleges. Bankers are different from venture capitalists. Each group's system and motivations must be evaluated to determine its potential and what will mobilize it. Government bureaucracies, which often monopolize important markets such as education and training, must also be evaluated. Evaluation of the asset base, and understanding the leaders and the culture of institutions, are the prelude to the setting of strategies.

c) Determine Objectives: Michigan decided that the primary objective of state government would be to promote immediate economic growth by supporting the rapid evolution of competitive industries. This became the Governor's unchanging priority and was emphasized to all audiences and constituencies.

d) Develop Strategies: Initially, Michigan's primary strategy was to help build the infrastructure of support needed by evolving industries, an infrastructure that included access to technology, risk capital, and training -- to everything necessary for a world-class manufacturing economy.

e) Design Programs: Michigan policymakers worked closely with people in key private and public markets to design programs that would influence private sector behavior.

f) Implement Programs: In Michigan, the effective implementation of programs required obtaining general public approval and some interest group approval, or at least indifference. Policymakers used various processes and various forums, such as advisory groups including Lee Iacocca, the Chairman of Chrysler Corporation, working groups made up of laywers and bankers, legislative debate, consultations with experts from throughout the country, and discussions with journalists and other opinion leaders.

The most difficult aspect of program implementation is mobilizing the government bureaucracy. Michigan has endeavored to convince typical bureaucracies to regard themselves as service enterprises of which businesses are valued customers and are treated accordingly.

g) Provide Leadership: As representatives of the business community's interests, Michigan economic policymakers had a responsibility to explain themselves to that community, and to educate its members about the infrastructure being built for the economy. In that way, they hoped to stimulate demand for the supply being created.

When Development Strategy Meets the Marketplace

In addition to viewing Michigan's path to a development strategy in terms of the seven steps discussed above, it is important to analyze those strategies in relation to the political climate and the economic marketplace. That requires policymakers to ask: How can government sell its program to business and the public? A premise underlying this approach to development is that government cannot simply impose its will on the business community. Especially required for this aspect of development are a sense of how the real world works and the patience to initiate the process that can create a consensus for moving forward.

a) Analysis and Momentum: Governor Blanchard instituted a study analyzing and evaluating Michigan's economic condition, but the State could not wait sixteen months for its conclusions before taking action. Accordingly, a set of programs was quickly developed, drawing from the agendas of big business, small business, labor, education, and traditional development activities. As a group, the programs were neither strategic nor focused, but they included elements that were popular with many groups, such as a highly visible summer work program for 25 000 teenagers. It was important to change the psychology of depression, and the programs announced that something, finally, was happening.

b) Objectives and Strategies: When the economic analysis was completed, Michigan's policymakers focused on reindustrialization, entrepreneurship, and human investment as the core of their initiatives. The problems advanced by interest groups, such as business's complaints about taxes, labor's complaints about workplace abuses, and education's complaints about lack of funding, were not ignored. But Michigan policymakers also began to build political alliances and new private sector relationships in key target areas: small manufacturing, new technology development, risk capital, and education and training.

c) Implementation and Orientation: Michigan has inaugurated dozens of new programs and new public/private institutions to implement its strategic aims. A key concern, even as new initiatives are tested, is to maintain creativity and flexibility by launching what the business community might call "new product improvements and innovations". In that way, Michigan sustains both political and economic momentum.

Partnerships

Partnerships are the glue of modern development. They require mutual benefits for the partners, joint investment of resources, mutually agreed decisionmaking processes, and accountability to the public and among partners. Partnerships attempt to close gaps in the public and private marketplaces that cannot be closed by existing institutions.

The following outlines some of the many kinds of partnerships that have grown in Michigan.

a) Advisory Partnerships: A strategic plan for Michigan's economic development was designed by representatives of the private sector led by Lee Iacocca and Douglas Frazier, the former President of the United Auto Workers Union, in cooperation with government officials.

b) Guiding Partnerships: The Michigan Strategic Fund, with $200 million for business investment, has by law a majority of its board of directors composed of representatives from the private sector. In concert with government officials, the Board shapes all of the Fund's policies.

c) Information Partnerships: The Auto-in-Michigan project is a forum in which important trends for the auto industry in Michigan are analyzed and discussed. It is composed of public officials and members of the private sector.

d) Investment Partnerships: Together with private investors, the Michigan Strategic Fund has capitalized new financial institutions that are operated by private managers. In addition, the state pension fund has directly invested in more than thirty companies in Michigan and has co-invested in new venture capital pools with private financiers.

e) University Consortia: The State has invested in consortia of public research universities which are seeking federal research dollars and which are commited to commercializing new technologies. Bringing universities together strengthens the State's research base.

f) Government Partnerships: The Michigan Department of Commerce has initiated "joint ventures" with each of three other departments, uniting their expertise, budgets, and decisionmaking processes. The latest effort is an attempt to promote better labor/management relations.

g) Service Partnerships: With state and foundation capital, the Industrial Technology Institute was created to help transfer technology to manufacturers and to conduct research on key technology issues, social as well as technical. The ITI board of directors includes representatives from large and small manufacturers, the State, universities, and banks, as well as a union representative. Its customers are businesses.

Conclusion

Partnerships are essential to economic development because the reshaping of economic behavior cannot be entrusted to existing institutions. They lack the proper definition of mission, the capacity and the culture to meet many of the new economic challenges.

The phases of development, and political realities, teach patience. Although managing short-term needs is important, economic development requires long-term strategies. There are no quick fixes.

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Chapter 11

Philadelphia's Partnerships for Economic Renewal

Ralph R. Widner

Alexis de Tocqueville, one of the most perceptive French commentators on American culture, wrote in the 1840s that "wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association".

Many Europeans are dismayed at the proliferation of organizations for various community purposes found in most American cities. Surely, in their eyes, it is a recipe for confusion and unnecessary complexity. But it is important to understand the cultural reason for the multiplication of citizen, community, and business associations in the United States. When North America was first being settled, the pioneers were obliged by sheer necessity to cooperate in meeting community needs. All kept a pail of sand inside their doorways to be used to extinguish a fire should it break out in the village. All joined together to build roads and streets. Families took in orphans and helped the poor.

Only when communities became larger and more complex were local authorities and public institutions created to carry out these functions. In fact, not until after the Second World War, did most cities view it as a responsibility of the local authority to promote the community's economic development. In the 1950s and 1960s, local governments across the nation finally created departments responsible for advancing economic development. Yet even then it seemed obvious that such public agencies could not accomplish the task alone. Since their purpose was to encourage private investment, it was necessary to create partnerships with the private sector whose investment decisions local authorities were seeking to influence.

Some partnerships are formally incorporated, quasi-public corporations to which the mayor appoints some members and the private sector appoints others. These corporations are frequently provided with their own revenue base to finance operations. In other less formal partnerships, the private sector finances activities to supplement those of the public sector agencies, and local authorities and private leaders jointly operate them as genuine community partnerships.

Greater Philadelphia

Philadelphia was once one of the premier industrial cities in the United States. It was also once the nation's capital, the birthplace of independence and the national constitution. At one time the largest city in the British empire after London, it is a city rich in historic buildings and old neighborhoods.

Greater Philadelphia is a metropolitan region of 5.7 million people, the fourth largest metropolitan region of the United States. Parts of the conurbation are in three states. Except in the case of transportation, there is no governmental authority with responsibility for region-wide development.

Until recently, as is common in many metropolitan regions in the United States, local authorities within the Greater Philadelphia region competed with each other to attract economic development. Suburb competed with city, and vice versa. Much of the new development was occuring on the metropolitan or suburban periphery while the central urban core declined in both population and economic activity. It was difficult to promote cooperation in economic development by all the local authorities in the metropolitan area.

The Greater Philadelphia First Corporation and the Economic Development Coalition.

In 1983, thirty chief executive officers of major corporations observed to themselves and to each other that they were failing to provide the kind of private leadership that would move the Philadelphia region into the developing new economy. They concluded that the civic structure of the region would have to be reorganized to permit the private sector to do its share, in conjunction with the numerous local authorities in the area. As a result, they took the lead and formed the Greater Philadelphia First Corporation.

Each of the thirty corporations that came together in Philadelphia had been making contributions, under a provision of federal tax law which provides tax relief for contributions to charity, to a variety of groups that were trying to address the region's economic problems. There was a proliferation of such groups: one was organized to try to attract foreign investment, another sought to train managers to operate in foreign markets, and yet another was created to foster cooperation between labor and management. There were forty-two such organizations, none of which was part of any local authority, all of which were private entities operating independently, and all of which depended on the charitable contributions of corporations.

In an effort to ensure that their separate activities would in fact contribute to the improvement of the region, the chief executive officers who composed the Greater Philadelphia First Corporation decided to gather the contributions into a common fund. They invited experts from every sector in the region to join the new organization -- the Greater Philadelphia Economic Development Coalition -- to make decisions, in cooperation with local authorities, about how the funds should best be spent to foster economic progress.

The elected leaders of all counties in the conurbation, and the executives of each county's economic development agency, sit on the board of directors of the Coalition, as does the chairman of every major private sector economic development organization in the metropolitan region. The privately financed partnership has become the primary vehicle for regional cooperation in economic development.

Restoring the Urban Core

During the industrialization in the last half of the 19th and early 20th centuries, much of Philadelphia's ambience was lost to commercial and industrial development, and blight. As the manufacturing economy declined, leaving many buildings and neighborhoods abandoned, the City pursued a strategy of restoring the qualities it had when it was "the Athens of America."

In the 1950s, urban redevelopment was viewed simply as a matter of using the power of local authorities to clear large sites of abandoned or blighted buildings and inviting new private development to take their place. During that period, Philadelphia embarked on two strategies: First, to create new corridors for office development by clearing major railway lines and rebuilding them underground; second, to restore abandoned commercial and industrial sites in the old, 17th-18th century neighborhoods by converting them back into residential areas attractive to upper and middle income residents. This strategy was intended to help staunch the decline of residential population in the central urban core. It was also hoped that once rehabilitation occurred, improvement would spread into surrounding districts through private initiatives attracted by the improved environment, without public intervention.

Both strategies have been successful. The Penn Center office corridor will be completed by the early 1990s and is home to much of Philadelphia's now burgeoning post-industrial economy. Most of this redevelopment occurred in the traditional way: the local authorities provided the incentives to attract private redevelopment by clearing land and writing down its cost to the market value the land would have had if it had been undeveloped.

Residential renewal of Old Philadelphia involved a public/private partnership. The Philadelphia Redevelopment Authority, a public agency, condemned blighted old houses and turned them over to the specially created Old Philadelphia Development Corporation, a private, non-profit organization which marketed the houses to people willing and able to afford to rehabilitate them. Earnings from these sales were used to obtain more properties. This project has become one of the most successful residental renewal projects in the United States.

The residential improvement in Old Philadelphia has spread. Families and firms are now rehabilitating deteriorated districts adjoining the newly restored colonial district, adapting old houses, warehouses, and factories to new uses, without subsidy from public funds other than the federal tax credit for the rehabilitation of historic buildings. Philadelphia has become the largest user of tax credits for historic rehabilitation in the country.

Restoration of the historic district made possible the conversion of the adjoining, formerly derelict waterfront. Centered on a new public plaza, a complex of restaurants, theaters, offices, and flats is now under development. Former docks are being converted into flats, indoor tennis courts, shopping malls, and the largest pleasure boat marina and nautical shopping mall in the United States.

The adjoining retail district, Market Street East, once the main department store district of the City, but for two decades seriously blighted and declining, is now being restored through a remarkable public/private partnership. Local and state authorities are turning the street into a tree-lined boulevard, while a private sector organization, the Market Street East Corporation, and independent firms are adapting abandoned buildings to new uses.

The Market Street East Corporation has created a fund of several million dollars to assume private responsibility for maintenance and security on the street. In this way, it is assumed, more efficient management of the boulevard can be sustained. Similar partnerships have been created by businesses, institutions, and residents near park areas in the City. Basic maintenance is the responsibility of local authority, but plantings and their care are a private responsibility.

Two other projects in the Market Street East corridor are examples of new public/private partnership strategies. The Gallery East Shopping Mall and Transport Center, one of the largest shopping malls in any American city, is a co-venture between the local authority and business interests. The City of Philadelphia is a co-investor and business partner in the project, shares in its profits, and realizes the new tax revenues it provides. Beneath the retail complex is a new, publicly financed, high speed rail transport terminal, which creates a new entranceway into the city.

The new Philadelphia Convention Center project involves the conversion of an old railroad station into a unique, publicly owned exhibition, and the private development of a 1 200-room hotel that is part of, and essential to, the project.

The key agency in developing the Gallery Shopping Mall and the Convention Center is the Philadelphia Industrial Development Corporation, a public/private partnership organized as a quasi-public corporation. It administers an industrial development "land bank", an inventory of city-owned land that is available for industrial development. Revenues earned from land sales finance the agency and its programs. It carries out 500-800 transactions each year and currently holds about 2 500 acres for development.

Building the Regional Economy

In addition to efforts aimed at restoring the urban core, Philadelphia's development strategy seeks to promote renewal throughout the metropolitan region. Guided by the five-year Strategic Plan administered by the Greater Philadelphia Economic Development Coalition, an army of public/private partnerships has been organized to deal with the many aspects of conurbation's economic development.

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Those partnerships employ a number of strategies to build the regional economy. In addition to addressing social problems that undermine economic strength, (for example, by earmarking nearly half of the corporate contributions to local authorities for education and training programs), they seek to create an atmosphere that attracts new business to the region and encourages the formation of new firms and the expansion of existing ones.

The two key organizations involved in trying to attract business to the region are the Greater Philadelphia Economic Development Coalition, discussed above, and the Greater Philadelphia International Network. The latter is an organization of business executives who seek to attract foreign firms and investment. Corporate executives commit themselves to helping in that effort by using their contacts with corporate executives elsewhere in the nation and the world.

Philadelphia's efforts to attract new business to the region have met with considerable success. For example, after economic analysis revealed that paramaceuticals constituted a major sector in the region's economy, and that there was a large body of scientific and technical workers for industry to draw on, Philadelphia successfully competed for a new national research center for manufacturing biotechnical products in the space shuttle, and was also successful in attracting a new pharmaceutical subsidiary of Eastman-Kodak to the region.

The University City Science Center provides an example of Philadelphia's efforts to create new businesses. The Center is a consortium of universities, businesses, and local authorities operating an urban research park, the oldest in the country, as an incubator for new advanced technology firms. Similarly, the Advanced Technology Center of Southeastern Pennsylvania is jointly financed by business and state government. Its purpose is likewise to support advanced technology research, to incubate new businesses, and to attract new research and development to the region.

The Delaware Valley Venture Capital Consortium is a forum of venture capitalists, financial institutions, and local authority economic development and pension fund managers committed to increasing the supply of capital for new ventures in the region. In four years they have created $100 million in newly available risk capital. Their approach is to encourage more social contact between entrepreneurs, investors, inventors, and researchers so that new firms and employment are generated as a result of their interaction.

To encourage the retention and expansion of existing businesses, the Greater Philadelphia Economic Development Coalition each year releases an Annual Regional Economic Report, indicating which sectors in the regional economy show potential for growth and which show signs of weakness. In declining industries that may have specific strengths in the region, special efforts are made to capitalize on competitive advantages to stabilize the sector or to encourage its growth.

Accomplishments

Philadelphia's partnerships are generating significant results. Greater Philadelphia's economy is now growing at about 65 000 to 70 000 jobs per year. Its strengths are in corporate administrative headquarters, business services, law, medicine, bio-science, pharmaceuticals, chemicals, bio-engineering and computer manufacture. No longer is it one of the world's leading manufacturers of locomotives, ships, steam turbines, or men's hats. Those days are gone. The new post-industrial day demands that economic development concentrate as much on creating an excellent quality of life and superior education and research institutions as providing industrial sites and transportation.

Mr. Widner is the Chairman of Fairfax House International and the former Executive Director of Greater Philadelphia First Corporation.

Chapter 12

Baltimore's Economic Development Partnerships

Bernard L. Berkowitz

Baltimore is a major port, an industrial and commercial center located about 60 kilometers north of Washington, D.C. It is the closest East Coast port to the industrial Middle West of the United States. Baltimore has a population of 750 000 and is the center of a metropolitan area with 2.25 million people. The chief local governments in the metropolitan area are Baltimore City and five separate counties, each of which has its own economic development agency.

Baltimore's Economic Development Agencies

Coordination and cooperation among the six local governments in the Baltimore metropolitan area is fostered by the Baltimore Regional Planning Council, an advisory body responsible for preparing a regional development plan. The six local development agency directors and representatives from the private sector are members of the Council's Economic Development Committee. Maryland's Department of Economic Development and Employment also provides coordination and assistance by promoting and marketing the state and by providing financing incentives.

Baltimore's chief private sector economic development organization is the Greater Baltimore Committee (GBC), which is also a metropolitan Chamber of Commerce. The GBC's Economic Development Council sponsors monthly meetings among its staff and the economic development directors of the six counties, to coordinate the promotion of the region and to plan lobbying efforts on matters of common interest.

The most important federal agencies affecting Baltimore's economic development are the Department of Housing and Urban Development, the Economic Development Administration of the U.S. Department of Commerce, and the Small Business Administration, which provide grants and loans to a variety of business development projects. The federal government and the State of Maryland play an important role in economic development by building and/or funding transportation facilities and other infrastructure improvements, and by locating government activities in the region.

The creative combination of public/private partnerships with financing packages that include city, state, private, and federal sources for private development within redevelopment projects has been at the core of Baltimore's success.

Baltimore Economic Development Corporation

Baltimore Economic Development Corporation (BEDCO) is the largest and most comprehensive of the local economic development organizations in the Baltimore area. BEDCO, which began operations in January 1976, has an ongoing contract to be the City's economic development arm. Although it has strong links with the private business sector, BEDCO is funded by Baltimore City.

About two-thirds of BEDCO's annual operating budget of nearly $2 million is derived from general city funds, the rest from fees for services, private contributions, and small federal and state grants. Because the five-member board of directors is appointed by the mayor, it is primarily the mayor and the city government who determine policy direction. BEDCO's staff of about thirty people is appointed by the chairman of the board. BEDCO's major functions are development, financing, and marketing.

Development includes managing the acquisition of vacant and under-utilized properties for development as industrial and business parks and buildings, managing the clearance and renovation of the sites, which may include installing streets and utilities, and marketing the converted properties. About 550 acres of land have been, or are being, developed in a dozen such projects, which are generally located from two to ten kilometers from the heart of the central business district.

Financing consists of making direct loans or providing guarantees from the City or BEDCO. These loans are almost always combined with private financing, and are often combined with state and/or federal loan sources. Attractive long-term financing of fixed assets has been the chief incentive offered by Baltimore. Real-estate tax abatements are available, but only in three specified state enterprise zones. In addition, BEDCO provides up to $100,000 in working-capital loans or venture capital for small or new businesses, provided that there is at least twice as much private financing in the deal.

Marketing involves selling Baltimore as a place for business location and expansion. BEDCO markets privately-owned sites and space as well as those in BEDCO development projects. BEDCO cooperates and participates in larger state and metropolitan marketing efforts, and also cooperates with several sister development corporations established by the city government to oversee redevelopment projects.

BEDCO's advisory committees and its loan committee are mostly drawn from the private business community, as is BEDCO's staff. BEDCO's president is a member of the Economic Development Council of the Greater Baltimore Committee, the Maryland Chamber of Commerce and the Mayor's Cabinet. Formal and informal links with the business community are very important to BEDCO, as are relations with the metropolitan AFL-CIO.

BEDCO's efforts have resulted in great success. It has saved nearly 28 000 jobs and has created 14 000 new ones. Its activities have stimulated $1.25 billion of private investment and the creation of 5.25 million square feet of building space. While the major part of BEDCO's efforts has been directed at retaining and expanding existing businesses, it has also encouraged growth industries, especially tourism, business services, and biotechnology, and has supported the formation of new enterprises.

Public/Private Partnerships in Baltimore

The success of Baltimore's economic development strategy is primarily due to three factors:

a) a "strong mayor" form of government which permitted the creation of a coordinated development program planned by city officials willing to take risks;

b) the availability of federal and, to a lesser extent, state redevelopment funds at the opportune time, in the 1960s and 1970s;

c) a public/private partnership which both sustained public confidence in the City's program and stimulated private investment in it.

Public/private partnership in Baltimore is best understood in a historical context. Baltimore and the State of Maryland have a long history of collaboration between government and business. For example, in the early 19th century, the City of Baltimore and the State of Maryland joined with private businessmen to form and invest in the first railroad in the United States, the Baltimore and Ohio Railroad. This was done to preserve the competitive position of the Port of Baltimore in the face of the construction of the Erie Canal by New York State. Similarly, public agencies and private business cooperated in rebuilding the central business district after the disastrous fire of 1904.

Baltimore's public/private partnerships are also favored by a long tradition of philanthropy. Private benefactors over the past century have funded the city's library system, the Johns Hopkins University, museums, the symphony, and other public and cultural institutions. Baltimore has a history of civic pride and responsibility within the business community.

The term public/private partnership encompasses a variety of specific types of collaboration whose activities include general policy support, joint funding of promotional and other economic development programs, and public and private joint investment in profit-making projects.

Partnerships for Joint Funding of Development Programs

The central, umbrella, public/private partnership in Baltimore is an informal relationship between the city government and the private sector through the Greater Baltimore Committee (GBC). The GBC supports economic development, transportation, education and other programs to revitalize the City and, as mentioned above, functions as the metropolitan area's Chamber of Commerce. When it was formed in 1956 by the 100 leading businesses in the Baltimore area, the GBC took the unprecedented step of hiring its own planning staff of architects, engineers, and economists to prepare a master plan and an action plan -- the 33-acre Charles Center Project -- for the then-declining central business district. The Charles Center plan was adopted by the City as an official urban renewal project, and was approved for general obligation bond-funding in a voter referendum. The management of the project, though responsible to the City, was headed by a "dollar a year" retired department store executive and was housed in a private office building rather than in City Hall.

Baltimore's role in the partnership was the acquisition of properties through the use of its power of eminent domain, and the funding of property acquisition and infrastructure construction, including the installation of streets, plazas, overhead walkways, and garages. The private role, in addition to formulating the plan, was to market the cleared sites and to finance their development. Public expenditures of $38.8 million included $10.5 million of city bond funds and $28.3 million of federal redevelopment funds. The investment, mostly private, in new and rehabilitated buildings was $200 million. Five thousand jobs were created in the project area, and city real estate taxes increased by $2 million per year.

The quick success of the Charles Center Project, despite its having been met at the outset with widespread scepticism, led to the initiation of the larger and even more daring Inner Harbor Project. The cost of planning this project was shared by Baltimore and the GBC. The federal government supplied about three-quarters of the $100 million public expenditure required for property acquisition and improvements; the City and State provided the rest. Nearly $2 billion of investment, mostly private, has been made in shopping and entertainment facilities, offices, apartments, and hotels. This complex, Harbor Place, has created thousands of new jobs, a new tourism industry and, ultimately, an additional $15-20 million annually in real-estate taxes for Baltimore.

Partnerships to Promote and Market Baltimore

Constructed by BEDCO in 1979, the Baltimore Briefing Center provides detailed information to the business community about Baltimore's advantages as a business location. The Center adjoins BEDCO's offices and overlooks the Inner Harbor, the evidence of Baltimore's success. It contains a model of the City, maps, photographs, a room for audio-visual presentations, and meeting rooms, all devoted to selling Baltimore. The annual cost of operating the Briefing Center is $225 000, of which the private sector contributes $100 000, the City (through BEDCO) $100 000, and the state $25 000

BEDCO's Downtown Office Marketing Task Force, whose mission is marketing downtown office space, has an annual budget of $250 000, of which $200 000 is derived from private developers, building owners and realtors, $100 000 from a private foundation, and $50 000 supplied by BEDCO.

Recent Public/Private Partnerships in Development Projects

The Point Breeze Industrial Center and the Johns Hopkins Bayview Research Campus represent recent successful economic development projects in Baltimore. Point Breeze is a new industrial park. The City acquired two-thirds of the land at virtually no cost from a major corporation which took advantage of a tax-deductible contribution to the City, and private developers purchased the remaining land. The City, through BEDCO, rents its land to the private developers using a complex formula that relates the amount of the rent directly to the percentage of building space occupied and inversely to the density of employment. Thus, developers are encouraged to seek tenants with high density employment as this results in lower rental payments. Point Breeze, which is only two years old, has created about 2 000 jobs.

The Johns Hopkins Bayview Research Campus is a partnership between Baltimore City and the Johns Hopkins University and Medical School to develop a major biomedical business and research park. The project is expected to result in 5 000 new jobs and $500 million of new investment by the year 2000. The cost of infrastructure, about $14 million, is being shared equally by the City, through BEDCO, and by a corporation established by Johns Hopkins. The City and the corporation will share equally in the net revenues from the leasing of the land for development. An asthma research center and a multi-tenant research laboratory building are currently under construction, which will result in 500 jobs. In addition, a new biotechnology company arising from discoveries pursued in the Johns Hopkins Neuroscience Department has been installed by BEDCO at the Bayview Research Campus. The company is a prototype of how university research can generate new business formation. It has grown from three employees in 1983 to 140 in 1988.

A Partnership for Private Profit

The Regency Hyatt Hotel in Baltimore's Inner Harbor is an example of public/private partnership used to finance a private project. The Hyatt Hotel was critically important to Baltimore's strategy of increasing tourism and convention business, but in the late 1970s the construction of a 500-room luxury hotel was a risky proposition. To encourage the Hyatt Corporation to build the hotel, the City agreed to significant financial participation, and in return, obtained a two-thirds share of the hotel's future net profits, in addition to loan repayments and substantial real-estate tax revenues.

The hotel was an instant success and one of Hyatt's most profitable projects. Baltimore is currently receiving about $3 million per year as its share of net profits. The tourism and convention business has grown to such an extent since the hotel was completed that the number of downtown hotel rooms has doubled. Clearly, this has been a very successful partnership for both the public and private partners.

Conclusion

The partnerships described here, and many others, have been crucially important to Baltimore's economic development. But it must be stressed that they are an outgrowth of Baltimore's particular historical and cultural development, and as such may be difficult to duplicate elsewhere.

Mr. Berkowitz is the President of the Baltimore Economic Development Corporation (BEDCO).

PART IV.

UNIVERSITY / INDUSTRY PARTNERSHIPS

Chapter 13

Introduction to Part IV: The Logic of Innovation

Economic decisionmakers consider universities strategic in the revitalisation of traditional industries and the stimulation of leading-edge industries. It is universities that carry out fundamental research and train engineers, technical staff, and specialist manpower. Universities are the source of technology transfers to major industrial groups, small and medium-sized enterprises, and local governments.

But universities cannot perform these vital functions alone, any more than industry alone can take on this political, economic, and social responsibility. The logic of innovation assumes a partnership between universities and industry, a partnership in which local government must play an increasingly important role.

Concerted Research

Recent years have brought a growing awareness of the role of science and technology in economic development(1), and of the increasing complexity and cost of fundamental and applied research. Few groups, not even powerful ones, are capable of carrying out research quickly if they try to do it alone. Consequently, companies are tending to put some of their research out to contract.

Universities are central to this development. As Professor Fusfeld points out in Chapter 14, American universities traditionally not only conduct research and teach, they also play a public service role: that of helping and advising industry and government. They undertake to put research into practice by furthering its development and distribution.

University/industry/government collaborations have raised a number of questions: How can industrial competitors co-operate with each other? How can universities maintain their independence from business? What are the respective roles of the partners in such collaborations? How can the balance between scientific, economic, industrial, and national interests be preserved?

The kinds of collaborations which are increasingly common in the United States help to provide some answers to these questions.

Three Directions

University/industry relations are going in three directions. The first of these is represented by the new collaborations between major partners in fundamental and applied research.

The second direction involves technology transfers that are so crucial to innovation. It is in this area that the technology universities have an essential role to play. Often that role means circulating scientific and technical information, sponsoring seminars, encouraging faculty to be consultants to industry, or welcoming industry researchers into university laboratories for co-operative research efforts. Some universities create technology or industrial parks, or establish small business "incubators" to promote the exploitation of technical advances. As Dr. Angel Jordan points out in Chapter 15, whatever their form, university/industry collaborations aim to shorten the cycle of innovation.

The third direction concerns the development of human resources. The Americans have observed that they train proportionally fewer engineers than their principal competitors, that the skills of almost half of their current workers will be obsolete by the year 2000, and that nearly one American in five is illiterate. These observations present a new field of university/industry collaboration to explore.

Continuity and Variations

University/industry co-operation has existed for a long time in the United States. The agricultural colleges, for example, were founded to improve the competitiveness of agriculture. Government has played an essential role in this co-operation. The federal government's direct contribution to basic research is 15.6 per cent and the universities' 48.4 per cent (though the latter obtain a substantial proportion of their funds from the federal government). In the United States, government funds 32 per cent of industrial research. France too has a history of university/industry interplay: the **grandes écoles** were established in the 19th century for the purpose of advancing the development of industry. In France, 28.7 per cent of funding for industrial research is provided by government.

The tension among the partners -- industry, university, and government -- are long-standing. Each partner has its own logic, priorities, and interests. Industry strives to be more competitive. Universities strive to protect their scientific freedom. Government seeks to protect the consistent pursuit of economic and social policy.

Trends in University/Industry Co-operation

Over the last two decades, there has been an increasing regionalization of university/industry partnerships and growing participation in them by local government. Most of the industrial states have launched vast research, technology transfer, and continuing training programs on a regional, county, or city scale. The trend began in the states suffering from deindustrialization, and has extended to states newly affected by the recession, such as Texas, which suffered greatly because of the slump in oil prices. University/industry/government partnerships are now central to regional strategy in most states, whether Democratic or Republican(2).

One of the most efficient models of university/industry/local government cooperation is Pennsylvania's Ben Franklin Partnership. In Chapter 16, Phillip Singerman describes the sophisticated yet decentralized network that has been created for local business and especially for small and medium-sized enterprises.

In addition to participating in regional development, universities are beginning to participate directly in businesses. Like many university faculty members and researchers, universities themselves have created high-tech small and medium-sized enterprises and are part-owners of the firms. The development is an outgrowth of Stanford University's practice, which originated in the 1930s, of renting or selling land to teacher-researchers setting up in business(3). Today, it is not unusual for universities to invest directly in high-tech firms which trade in the discoveries made in the universities' laboratories.

University/industry partnerships have begun recently to focus their effforts on small and medium-sized firms. It is such businesses that create the most jobs. Because they must have broad access to emerging technologies in order to be competitive, priority is given to them in technology transfer projects. In Chapter 17, Cynthia Bloomquist discusses the entrepreneurial spirit at MIT, which administers some of the most effective university/industry partnerships to be found.

What are the current trends? A growing complexity which encompasses the earlier forms of collaboration. Thus, the individual consultant (the traditional form of university/industry association) has given way to a consulting practice plan. The emergence of intersectoral collaboration has prompted programs such as industrial parks, cooperative research centers, and business incubators, and has given rise to partnership structures that are neither wholly private nor wholly public. Finally, by placing these new structures at the periphery, the independence of the hard core of university research is preserved.

Pierre Dommergues

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Chapter 14

University, Industry, and Regional Development

Herbert I. Fusfeld

Universities play an increasingly important role in the development that has been such an important factor in job creation in the United States.

Their importance is due in part to specific technical developments at the universities, and in part to the involvement of faculty with existing or new industries. But most critical is the stimulation which an active university provides to a variety of regional programs: education, retraining, cultural activities, real estate development, and new investments generally.

Nearly every region of the United States has witnessed the importance of universities to economic development. The most notable examples of it are Route 128 near Boston, Silicon Valley south of San Francisco, and the Research Triangle in North Carolina. Today, there is similar development in Austin, Pittsburgh, Salt Lake City, Philadelphia, and the Capital District of Albany-Troy-Schenectady in New York State.

The Role of Universities

The presence of a major university, while it can be a powerful influence, is not absolutely essential to regional economic development. There are regions, such as Long Island, in New York, which had a strong defense electronics industry, where technically-based development occurred without the direct involvement of a major university. Nor does the mere presence of a major university insure regional growth -- many great American universities did not produce a Route 128. The development of Route 128 resulted from the interaction of MIT and its faculty with industry, not from the presence of the many other outstanding a academic institutions in the region. University participation must be based on the desire and initiative of the university administration and faculty.

The formation of new companies and the creation of new opportunities for existing ones based on technical advances originating in universities, may be only a minor factor in terms of direct economic growth. But such technical advances can have a major influence on indirect growth resulting from the general stimulation of industry, the enthusiasm of the community and its political leaders, and confidence in the future. It is those conditions which create the best climate for investment.

Substantial results require time. Route 128 had its beginnings during and after World War II. Silicon Valley had its origins in the vacuum tube industry of the 1920s and the start of Hewlett-Packard and Varian in the 1930s. The Research Triangle attracted its first non-industry groups in the early 1950s. Austin, Texas is making rapid progress but will require many years to build a broader base for growth.

Partnerships

University involvement in regional economic development is squarely within the American political and social tradition of community action and local partnerships. The growth of such involvement corresponds with the growth of university collaboration with industry. University/industry collaboration has modified the activities and functions of universities so as to make them more willing and more able to take an active role in regional development.

Rensselaer Polytechnic Institute's Center for Science and Technology Policy has extensively examined university/industry interaction in terms of the objectives of the parties, the conditions needed for and characteristics of successful collaboration, and the role of government funding.(1)

The Center's studies show that industry's primary reason for supporting university research is to develop a source of future technical employees, and that 70 per cent or more of university/industry co-operative efforts arise from university initiatives. Similarly, between 60 and 70 per cent of industry-funded university research programs result from consulting relations between a faculty member and the company providing support. Approximately 86 per cent of co-operative research programs are in engineering, medicine, and agriculture.

Although industry funds constitute about 15 per cent of the research budget at MIT, and about 30 per cent at such research universities as Rensselaer, Carnegie-Mellon, Georgia Tech, and Worcester Polytechnic, industry funds account for less than 5 per cent of total research support at most of the top 200 research universities. But, while industry contributes only a small portion of total university research funding, about 6 per cent in 1987, its contribution has risen from the 3 per cent it contributed in 1981.

The University's Changing Mission

Whatever form they take, the new American university/industry interactions testify to the changes that universities have undergone, changes that in part account for the greater university activism in regional development.

The traditional role of the university has been to acquire knowledge through research, to transmit knowledge by teaching, and to apply knowledge through public service.[2] Research is a logical companion to teaching -- it advances the limits of knowledge and maintains a competent faculty. The traditional public service role of universities was to provide advice to government and industry.

Before the Second World War, the amount of research activity by teaching faculty bore some relationship to the size of the student body. During the War, and in the years that followed, federal funding expanded research in many universities to an extent that had no relation to the number of students there. Thus, research became an important university function, independent of teaching. The university's role as a major producer of technical advances made it an important contributor to the country's growth. Universities became particularly active in public programs relating to defense, space, and energy, and in private programs relating to economic development.

The University as Entrepreneur

As universities engaged in more and more research, they began to give more and more attention to using research results. This was partly a logical extension of the traditional university mission of applying knowledge through public service, and partly the result of the financial constraints that began to beset universities in the early 1970s. Universities explored the possibility of making money by encouraging industry to exploit university research.

Historically, universities exploited research by licensing patents obtained on the research results. Patenting was done randomly, usually on the initiative of the researcher, and it was expensive. Sometimes universities turned the responsibility for seeking patents over to an outside organization which obtained the patents, sold licenses to corporations, and returned part of the royalties to the university. Thus, the university did not engage in commercial activity, the faculty was not distracted, and some income was derived.

Although universities gradually expanded their patenting activities, by the mid-1970s they were no longer asking themselves how to derive the greatest income from patent licensing, but how to obtain the greatest income from research. The large research universities began to bring in people with business backgrounds, often former technical executives from industry and even some with venture capital experience. These people began to explore such options as owning equity in a company that used university research, entering into research and development limited partnerships, and participating in joint ventures that included university research efforts.

The growth of university entrepreneurship was accompanied in many cases by the development of "incubators" in which to encourage the birth of new ventures. Where possible, development of "science parks" served to attract technically-based companies.

The increased research at universities after World War II focused attention on the exploitation of that research. This led to the growth of "business development" activity and personnel at the universities. It was accompanied by closer interaction with industry. Finally, the growing involvement with the transfer and commercial use of university research developed a favorable climate for a wide range of regional development programs.

Conflicts of Interest?

There has been much uneasiness in the academic community about possible conflict between business development activities and the pursuit of traditional university functions. Informal guidelines have been established to insulate faculty from commercial negotiations and to relieve universities of actively operating businesses. Faculty are encouraged to serve as consultants or board members, but not be a part of company management. Nevertheless, American universities are many and diverse. A few of them do in fact engage in commercial activities. There are many rules governing faculty patent rights, faculty participation in outside corporations, and university/corporation ventures.

There is no doubt that research universities are aware of the opportunities for co-operation with industry and for participation in the economic development of their regions. They are sensitive to the commercial potential of university research and to the stimulus that their faculty can provide to local programs.

As universities continue to play a more and more active role in the American economy, they must meet the challenge of remaining an independent base for research and education. And society must meet the challenge of involving the university in economic growth without disturbing that base. The evidence to date demonstrates that the challenges are being met successfully.

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NOTE

Rensselaer Polytechnic Institute

The Rensselaer Polytechnic Institute was founded in 1824 in Troy, New York. It is the oldest engineering school not only in the United States, but in the English-speaking world. In addition to pursuing its traditional academic activities of training engineers and conducting research, Rensselaer has, from its origin, played an active role in furthering industrial innovation and productivity, and in creating jobs.

From 1824 to 1940, the economy in the Troy area was based on traditional industries: textiles, iron and steel works, and energy. Rensselaer graduates built the area's factories, canals, and bridges, and staffed the region's businesses. Business leaders supported Rensselaer by donations of funds, scholarships, and research contracts. Although university/industry collaboration was still in the early stages, there were nevertheless direct technology transfers from Rensselaer to its neighboring industries.

Between 1941 and 1981, Troy's economy was characterized by deindustrialisation and technological expansion, and Rensselaer became involved in applied research. In 1977, in collaboration with the local business community and with the support of the National Science Foundation, Rensselaer founded the Center for Interactive Computer Graphics, one of the best such centers in the world. Similarly, in order to further the modernisation of traditional industries, in 1979 Rensselaer created the Center for Industrial Productivity and Technological Transfers. finally, in 1981, Rensselaer inaugurated the Center for Integrated Electronics, in co-operation with companies located in the Northeastern United States, among them General Electric, IBM, and Digital Equipment.

Since 1980, Rensselaer has given priority to developing the new economic forces at work in the United States: the service sector, small businesses, and high-technology. It has created a business incubator program which offers participants, in addition to rents and shared support services at reduced cost, direct access to all of Rensselaer technological information and resources, such as computerlinks, databases, and laboratories, and access to the advice of the Institute's research staff. To qualify for the program, participants must be seeking to develop technical innovations for existing or potential markets. They must also be seeking to develop or establish a relationship with Rensselaer, and must be able to pay the rent as well give Rensselaer a participation of more than 2 per cent.

The first company to emerge from the incubator set up its business on Route 128. To discourage businesses from locating elsewhere, Rensselaer established its technology park, where it rents land or buildings to new or expanding small businesses. Between 1983 and 1986, 38 companies located there, creating 350 jobs.

In 1983, Rensselaer's school of management introduced a curriculum in which students and local business managers can learn management skills in the context of new technologies. The objectives of the program are to teach the application of the new technologies to business enterprises, to prepare research and development plans, and to shorten the time between the creation of new products, processes, and services and their commercialization.

How long did it take to achieve the high level of interaction that exists between Rensselaer and the business community? A century and a half. And much professionalism and perseverance.

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Chapter 15

Technology Transfers: Carnegie Mellon University

Angel Jordan

The United States excels in research and development. Japan and other Pacific Basin nations excel in production and distribution, of both products and processes. Within the United States, Massachusetts and California excel in both research and development and production and distribution. Pennsylvania, where Carnegie Mellon University is located, excels in research and development and is actively seeking to improve its performance in production and distribution. North Carolina and Texas are adopting research and development from other states and are concentrating their efforts on production and distribution. Each of these states is establishing policies and pursuing initiatives to accelerate progress, albeit in different stages of the innovation cycle. The entire country is preoccupied with how to accelerate the transition from state-of-the-art in science and technology to practice. Europe, aware of the "technology gap" that separates it from the United States and Japan, is also taking steps to accelerate innovation.

University/Industry Collaboration at Carnegie Mellon University

Carnegie Mellon University has wide experience in collaborating with industry. To be sure, it is not the only institution in the United States or Europe that fosters such alliances, but it is often singled out as an example.

Carnegie Mellon continually searches for forms of collaboration with industry where the objective is technology transfer. Industry often approaches Carnegie Mellon with the same aim. Technology transfer is a two-way street. Sometimes, advanced technology is in the university, waiting for an outlet in industry. At other times, fairly advanced technology has been developed by industry and is waiting to be perfected in the university. When the technology is transferred to the university, it is often the driving force for new research which in turn triggers new production and distribution by industry. Thus, the different stages of the innovation cycle are amplified.

Technology Transfer at Carnegie Mellon University

There are many centers and institutes at Carnegie Mellon, both inside and outside the schools and departments of the University. The following highlights those that are most involved in university/industry collaborations, with emphasis on technology transfer.

The Magnetics Technology Center is funded by the federal government and a consortium of companies interested in magnetics. The companies participate in the Center either as industrial associates or as industrial affiliates. The associates provide a high level of funding and send staff to work in the Center, with faculty and graduate students from the university, for long periods. The industry staff bring with them their technical expertise and their companies' non-proprietary technology. The affiliates provide lower levels of funding, and benefit from the general research and development conducted in the Center. The Center has been a source of magnetic technology transfer from university to industry for ten years, and is considered to be, in the United States and abroad, a center of excellence.

The Iron and Steel Making Center operates like the Magnetics Technology Center, transfering its research and development output to sponsoring companies. Its objective is to revitalize the steel industry by focusing on modern techniques and processes.

The Pittsburgh Supercomputer Center is a partnership between the University of Pittsburgh and Westinghouse Electric Corporation. It is one of five supercomputer centers in the United States. Funded by the National Science Foundation, with contributions by the State of Pennsylvania, the Center's objective is to advance the state-of-the-art in scientific and engineering computing by technology transfer to its industrial affiliates.

The Software Engineering Institute's key mission is to accelerate the transfer of the state-of-the-art in software technology into practice. The Institute is a division of Carnegie Mellon and works in association with other universities and industrial affiliates. Both send technical staff to work in residence for extended periods with full-time researchers. The Institute's five-year renewable budget is $100 million, provided by the Department of Defense.

The Mellon Institute is an agent for technology transfer between the University and industry. It is devoted to company-sponsored industrial research. The researchers work full-time in company-funded research and development, with university faculty working part-time and contributing their basic research to industrial projects.

The Computer Science Department, which is about to become the School of Computer Science, is one of the strongest computer science academic research units in the world. It emphasizes programming systems, software engineering, computer systems and hardware, theory of computation, and artificial intelligence. It is well funded by federal agencies, and by companies through industrial affiliate programs. The Department has generated numerous software and artificial intelligence companies, and has been a magnet that has attracted companies to the region, representing many examples of technology transfer. Early developments in artificial intelligence and software technology that took place in the Department influenced additional developments in science and technology in other parts of the Uuniversity, particularly in the Engineering Department, in cognitive and social sciences, and in the Engineering Design Research Center, a center funded by the National Science Foundation and industrial corporations.

The Robotics Institute is an outgrowth of the Computer Science Department, which provided the impetus for it and is its nucleus. The Institute was formed in 1979 to advance the state-of-the-art in Robotics and Intelligent Systems. It is multidisciplinary, with about 120 researchers. Technical staff from sponsoring companies work with faculty and students from the Departments of Computer Science, the Departments of Mechanical, Civil and Chemical Engineering, and the Graduate School of Industrial Administration.

Carnegie Mellon University and Regional Economic Development

As a major research university, Carnegie Mellon plays an important role in research and development, and in the creation of technology. But in addition to disseminating knowledge and fostering university/industry partnerships, the University and its faculty take an active part in regional economic development.

Carnegie Mellon, in collaboration with the University of Pittsburgh, provides the site and leadership for the Western Pennsylvania Advanced Technology Center, one of the four advanced technology centers in Pennsylvania under the Ben Franklin Partnership Program. The objectives of the program are to foster economic development in the regions, to create and retain jobs by transfering technology to the work place, and to create new enterprises. The University's share of the funding from the state is about $4 million matched with approximately $10 million from corporations. Most of these corporations are small, and they obtain the benefit of the transfer of technology from the University to expand and to create new jobs. Although the level of funding is small compared with the total research and development funding in the University (about $115 million a year), it is specifically focused on economic development.

Carnegie Mellon and the University of Pittsburgh also sponsor the Enterprise Corporation, a non-proift corporation funded by the Allegheny Conference on Community Development, the Western Pennsylvania Advanced Technology Center, and by private foundations. The Enterprise Corporation's mission is to help entrepreneurs to form new businesses. To this end, it organizes workshops and seminars on entrepreneurship, provides individual consulting to entrepreneurs, and introduces them to sources of venture capital and financing.

Carnegie Mellon is also active in the Pittsburgh High Technology Council, a trade association of business, universities, and community leaders fostering the growth of advanced technology companies in Western Pennsylvania. With the Penn Southwest Association (a marketing organization funded by the Allegheny Conference on Community Development), the Pittsburgh High Technology Council is helping revitalize the region and is instrumental in changing it from a smokestack economy to one based on high technology. The original leadership of the Council was provided by the University.

Carnegie-Mellon is currently undertaking the formation of the Pittsburgh Technology Center on a site formerly occupied by a steel mill. This center will be a high technology park. One of its buildings will provide expansion space for university research and development activities that interact closely with industry. Other buildings will be occupied by corporations wishing to be close to the research centers and institutes of Carnegie Mellon. It is anticipated that the Pittsburgh Technology Center, in which the University of Pittsburgh is also a participant, will be the source of significant economic development in the region.

Conclusion

Carnegie Mellon University demonstrates that research universities, as primary sources in the creation of knowledge, can play an important role in economic development. By engaging in university/industry alliances, Carnegie Mellon does not distort its primary mission of creating and disseminating knowledge. Such partnerships implement technology transfer, accelerate the innovation cycle, and hasten the transfer of the state-of-the-art into practice. University/industry relations generate new companies in the region and attract businesses there. Those enterprises maintain close relationships with the University, thus perpetuating the cycle of innovation and growth.

Dr. Jordan is the Provost of Carnegie Mellon University.

Chapter 16

Centers for Advanced Technology Transfer: the Ben Franklin Partnership

Phillip A. Singerman

Since 1983, the Ben Franklin Partnership has invested over $100 million of Pennsylvania state funds in advanced technology activities. These funds have leveraged over $300 million in funds from private, foundation, federal government, and local government sources. Ten thousand jobs have been created and retained, and over 500 new companies have received start-up assistance.

The Partnership operates through four regional Advanced Technology Centers. The Center for Southeastern Pennsylvania has an annual budget of $40 million, of which $7.5 million is provided by the State. In 1988, the Center is supporting 150 advanced technology projects in its region, involving 200 companies and over 60 education, research, training, and economic development organizations.

Program Goals

From its inception, the Governor and the State Legislature set out three very clear public policy goals for the program. The first of these was to create and retain jobs in Pennsylvania's advanced technology enterprises. Because job creation occurs primarily in small or new companies, the program focuses much of its resources on such entities.

The program was also aimed at improving productivity in Pennsylvania's existing firms, with special reference to traditional industries such as steel, textiles, shoes, and coal. Working with existing industries is particularly important to achieve a balanced program. The very name of the Center -- the "advanced" technology center -- was consciously chosen in order to avoid the exotic connotation that the phrase "high" technology would carry. Thus, the program's second focus of activity is to improve the processes of existing manufacturing by the application of technology.

The program's third goal was to diversify Pennsylvania's economy in order to increase its share of advanced technology firms and product markets, especially in growth sectors such as pharmaceuticals, computer science, and new materials.

Program Organization

Experience has shown that partnerships should involve both public and private actors. The Ben Franklin Partnership is organized accordingly, with the inclusion of labor representatives among the various boards at state and local level. The Philadelphia program, for example, includes representatives from the teachers' union and from the area labor management committee. Labor participates in all aspects of the program.

The program is decentralized regionally. Each of its four technology centers is operated by a local organization affiliated with a university and is managed under a contract with the State. The key aspect of the decentralized nature of the centers is that they are not state agencies, their employees are not state employees, and the centers are not, therefore, subject to the rules and regulations that govern public agencies. As a result, the program operates flexibly, and in an entrepreneurial manner.

Each year the four centers compete with one another for the appropriation that the legislature has authorized. The award of funding to each of the centers is based on a clear and publicly known formula which takes into account the centers' performance and the quality of the proposals advanced. Funding is not based on political or institutional grounds. For the sceptical, that the program operates under a concept of performance-based funding in fact as well as in theory is demonstrated by its history: for several years the smallest center received the most funding; Philadelphia, the largest region, was a distant third in the funding competition; Penn State University, the most powerful educational institution in the Commonwealth, has traditionally received the least funding among the four competing centers.

All of the centers rely a great deal on technical advisory councils, groups of experts from industry and the academic sector, which decide on policy and funding priorities. This feature of the program's organization helps it to avoid a frequently expressed misgiving about public programs -- that they cannot make choices, cannot pick winners, and are hopelessly mired in supporting losers. The program's wide reliance on its technical advisory councils, which require substantial information from program participants, allows the centers to focus their activities on industries and companies that will prove to be successful.

Program Activities

An important feature of the program is its comprehensiveness: it focuses simultaneously on research, on the training needs of companies, and on giving business assistance to small companies. This feature is crucial, because companies have different needs at different stages of their development: at one point a company may need business assistance to get started, then it may mature sufficiently to work in research collaboration with universities, and, finally, when it has developed a product and is manufacturing it, it may need training assistance for its employees. The program assists in each of these aspects of a company's growth.

Equally important, the comprehensiveness of the program provides the opportunity to involve a broad range of companies and institutions. Over 130 educational institutions are involved, including not only the major research institutions but also community colleges, vocational education schools, and a variety of small liberal arts institutions which, while lacking broad research expertise, have a variety of other talents to offer industry.

Rather than working in generic areas, the program funds specific projects uniting companies and research institutions. Those projects have specific goals and seek specific results.

The program employs the concept of leverage, or matching funds, both as a technique for acquiring additional resources and for testing the market potential of the activities it supports. The commitment of resources to a project by a private entity or a local government supports the program's judgment that the project is worthwhile. The matching funds technique makes the program neither a provider of funds of first resort nor of last resort, but an investor participating with co-investors.

Program Operation

It must be made easy for participants to engage in the program, and therefore its primary feature must be simplicity. There cannot be paperwork or complicated forms to complete before companies can avail themselves of the program's services.

The Ben Franklin Partnership has in the past, to its detriment, forgotten the value of simplicity. At one stage its managers tried to enter into equity agreements with the companies being funded, with the result that a great deal of revenue went to lawyers but none went to the engineers. So much time was spent negotiating the agreements, and so much money was spent on legal fees, that several projects were abandoned. The program has moved away from complicated procedures, and enters into simple contracts with its small company participants.

It is important for the program's credibility that it appear to be and actually is open to all. Any presumption that it is open only to the old boy network, or that only large companies and the established research institutions can participate, must be avoided.

It is particularly important for legislators and government officials to bear in mind that programs such as the Ben Franklin Partnership must be allowed to take risks and, consequently, must be allowed their failures. Programs judged only by their successes in the short term are doomed: they will quickly turn potential entrepreneurs into bureaucrats. The Ben Franklin program strives to be risk-taking, to be sufficiently flexible to respond to the market and new opportunities, and to be always willing to change.

The Ben Franklin Partnership is a focused program which adheres to the notion that a technology-based development program cannot be all things to all people. It has identified certain substantive areas and market niches appropriate to its region where it can make an impact, and it focuses its activities accordingly.

The Roles of the Participants

The public sector's role as a participant in a development program such as the Ben Franklin Partnership is twofold: it provides leadership and it provides seed funding.

The question is frequently asked: "Who initiates these activities?" In Pennsylvania, it was the state government: the government was the only entity with sufficient scope, responsibility, and resources to undertake such a venture. No private entity, no university could have played that leadership role.

The government also had to provide substantial seed funding to get the program started. Since then, it has enjoyed bipartisan support in the legislature, and support from two governors from two different parties. Much of this support is due to the way the program was conceived and organized, and the way it is managed. The Partnership recognizes that it is ultimately accountable to the public sector in terms of the public policy goals which the legislature set forth in the program's appropriation. Fortunately, in addition to the funding, the legislature has given the program sufficient flexibility to carry out the mission entrusted to it.

University participants in the program provide a research infrastructure and technical expertise which would otherwise be unavailable to developing companies. On its side, industry provides business know-how and financial resources.

Benefits to Participants

The program is designed in such a way that each participating sector uniquely benefits from its interplay with the other members of the partnerships. Industry has access to university resources as well as to a source of trained employees and new ideas. Universities are more able to attract and retain quality faculty and students, to keep current on new technologies, and to develop relationships outside their academic communities. The regions enjoy job creation and job retention. New companies are formed, existing companies improve their processes and develop new products, and new business is attracted to the region.

Conclusion

The most important elements of the Ben Franklin Partnership are: First, clear goals: if goals are vague, it can never be known if or when they are achieved. Second, decentralized organization it makes economic sense.

Third, comprehensive activities: the program focuses on a wide mix of projects and enjoys broad political support. Finally, flexibility: the program can change in response to opportunities in the market.

Dr. Singerman is the Executive Director of the Advanced Technology Center of Southeastern Pennsylvania.

Note: Evaluating the Ben Franklin Partnership

David Osborne

The Ben Franklin Partnership is probably the most comprehensive economic development institution in the country. If an entrepreneur needs inexpensive start-up space, Pennsylvania has 30 incubators -- more than any other state. If he or she needs technical assistance, each center offers several options. If research is the problem, challenge and seed grants are available, or the local Ben Franklin staff can help the firm apply for a federal grant. If capital is the problem, both seed and traditional venture capital funds are available. If the company needs loans rather than equity, the staff can refer it to local bankers or to state or regional loan funds. If an older company needs new technology to survive, teams of experts are available to help.

Equally important, these services are available locally. A business person does not have to travel to the state capital to deal with any of them. In fact, a business person is hardly aware that he is dealing with a state program. Most of the services -- research, technical assistance, analyses of production processed, venture capital -- are not provided by state programs. The state simply offers a matching grant to encourage business people to use academic resources, or to create seed funds, or to finance incubators, or to provide technical assistance. Once those resources are in place, the centers operate sophisticated referral services. The object is to change private sector behavior in ways that stimulate innovation and productivity.

The Partnership would have been even stronger had the legislature passed a Technology Assessment Program proposed in 1986 by then-Governor Thornburgh. The idea was to provide more money -- $6.25 million in the first year -- to finance new activities. Pennsylvania already had a program, called PENNTAP, through which eight "technical specialists" at Penn State University campuses helped small businesses with technical information and referrals to university or private sector consultants. But the Technology Assessment Program would have gone much further. It would have provided on-site consulting, low-interest loans for the purchase of new equipment, and hands-on assistance in integrating new equipment into production lines and training workers to use it.

Infusion of Private Capital

Supporters of the Partnership argue that the proof of its value is the amount of money that business has put into its projects. In the program's fourth year of operation, private corporations matched $26.45 million in challenge grants with roughly $20 million in case and $48 million in equipment, laboratories, and staff time. (Another $40 million came from other sources, including the universities, the federal government, and foundations).

Partnership enthusiasts also note that firms receiving grants attracted $61.4 million in private venture capital during the program's first four years. "This is not something we thought about that much when we designed the program", says one of the programs creators, "but a lot of venture capitalists see us as an imprimatur, because we're turning down three projects for every one we fund, and we have review committees at each of the centers. It's a fairly selective process, so we're doing some of the weeding and screening for the venture people. You have to look at this in perspective. In 1983, there was $31 million raised in Pennsylvania in its entirety for venture capital, and I'm sure most of it went out of state. Then along comes Ben Franklin, and we've got $61 million in our projects from venture firms all across the nation, all in Pennsylvania".

Changing the Academic Community

The Ben Franklin Partnership is not designed only to help business, however. It is also designed to change academia. "The program is a success as a culture transformer," says Peter Likins, President of Lehigh University, "It creates a different kind of environment in universities. The state money is not coming in here to finance a faculty member's exploration of their personal curiosity. It's coming in here to finance a faculty member's pursuit of a concern that has its roots in some company".

"Initially", adds Emory Zimmers, a professor of engineering at Lehigh, "some professors at Lehigh feared that the program would move academic research "too much from the 'R' to the 'D'. But in reality it helps to focus the research on more critical issues, both long and short term. People that don't have any contact with industry tend to create a cure for no known disease. They mask that by saying, 'Well, I'm 20 years ahead of my time'. In reality, their time never comes. Academia is inbred, and this program opens it up a little."

Another intangible factor is the program's role in mobilizing local business, academic, and government people to work together in new ways. By requiring the involvement of many players in local boards and consortia, the State has attempted to generate a process that will gather momentum on its own. Because it has allowed these local players to shape each center to fit the region, it has succeeded in very different environments.

The program is not perfect. Not all the centers are equally vital, for instance. Because of the rural nature of its territory and its lack of historic orientation toward the private sector, the Penn State center has lagged behind the others. Conversely, the other centers could profitably use double the money they now get, because they each turn down as many solid proposals as they accept.

Critics argue that some of the centers have become too dominated by the universities. Ron Thomas, who now sits on the local board that oversees the Lehigh center, feels that Lehigh University has gained effective control of the program. As a result, he says, the research money is too directed toward academic interests, and participating businesses are suffocating in red tape and bureaucracy. "Right now I've got one grant, and if I want to expend over $100, I have to have five signatures", Thomas says. "That would take me at least six weeks to two months. You fall into the bureaucracy of the university, and it prohibits you from accomplishing anything".

Thomas also points out that the universities have refused to give up their patent rights on any research their professors conduct. Companies sponsoring the research have to sign licenses to use the results. Because of this, "as soon as a company like ours gets into any kind of position of financial strength, it cuts off that university research, because they're not about to share their patents with a university researcher". Thomas believes that the Partnership would have more impact of 73 per cent of its funds went to business and 27 per cent to academics, rather than the other way around.

Others, such as Peter Likins, disagree. But even Likins agrees that the program has one weakness: its use of the number of jobs created by each project as a major determinant of funding. The Ben Franklin Partnership is not designed to create jobs in the short run; it is designed to create new products and processes, to heighten productivity, and to increase the number of start-up companies spun off by Pennsylvania universities. If those goals are met, jobs will follow -- in the long run. Yet funding is partially determined by short-term job creation, and the public is told that the Partnership is a jobs program.

"I think it is dangerous to put the centers in the position in which they have the impression that the more jobs they report creating -- or worse, saving -- the more money they get", says Likins. "Because these things are very difficult to document accurately and honestly".

The Program creators and the state board recognized these problems, but believed that job creation figures were necessary to get support from the legislature, and that the use of job-creation figures forced the universities to concentrate on projects with commercial potential. If the program erred anywhere, it erred on the conservative side in counting jobs. Still, virtually the only negative publicity the Partnership has received came when the Philadelphia Inquirer traced down two cases of exaggerated job claims in an early press release.

A Model Program

Despite these quibbles, the Ben Franklin Partnership is a model program -- and it is recognized as such throughout the nation. It is comprehensive; it is decentralized; it catalyzes significant private investment in important economic activities; and it has mobilized major local players in new ways. It is also focused on important targets: the commercialization of research, the transfer of technology from academia to industry, the generation of risk capital, the birth of new firms, and the integration of advanced technology into mature industries. Its continued success will depend upon the ability of the state board to resist the constant pressure from the universities to use the money for basic research, new buildings, and other academic priorities. But the anecdotal evidence suggests that, to a surprising degree, the board has done so. The result is arguably the best state economic development program in the country.

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Chapter 17

Entrepreneurship in the University: The Massachusetts Institute of Technology

Cynthia Bloomquist

A recent survey conducted by MIT's Resource Development staff shows that 404 firms operating in Massachusetts could be identified as having been founded by MIT faculty or alumni.(1) Those firms employ 163 554 workers and have an annual turnover of more than $27 million, one-fifth of the Gross State Product.

According to *Fortune* magazine,(2) 20 000 jobs have been created since 1980 along "AI Alley" (Artificial Intelligence Alley), which abuts MIT's campus and which houses the MIT Artificial Intelligence Laboratory. It has been said that the figure is higher than the total job growth in thirteen states, Pennsylvania and Illinois among them.

In the 1960s, a dynamic new industry evolved in Massachusetts. It was based largely on the minicomputer which was developed from research done at MIT by Jay Forrester and his student Kenneth Olson, who in 1957 founded the Digital Equipment Corporation. The industry grew quickly but it suffered from certain problems, both internally and as a result of the general economic climate. The new firms were too dependent on defense and space-related work. In addition, Massachusetts suffered disproportionately from the national recession in the early 1970s, a situation aggravated by the 1973 oil crisis -- Massachusetts has severe winters and depends on oil for 80 per cent of its energy needs. Wage rates and the cost of living are high. That, coupled with taxes 10 per cent higher than the national average gave Massachusetts a reputation for being hostile to business.

In 1975, unemployment peaked in Massachusetts at 11.2 per cent, compared to 8.5 per cent nationally.

The Turnaround

By 1976, a turnaround in the Massachusetts economy had begun. Spurred by pressure from industry, the State began to take an active role in economic planning and development. The national recession eased, and even though defense work returned, companies diversified into commercial markets. Tax rates dropped. But the most important change at the state level may have been new willingness to be accommodating toward business.

An MIT researcher has shown that a locality must replace 8 to 10 per cent of its jobs annually simply to make up for losses. The ability to continue to replenish the job pool demonstrates the vitality of a local economy. The Massachusetts Miracle,(3) edited by a member of the MIT Industrial Liaison Program staff, summarizes the factors which combined to produce Massachusetts' success.

What are those factors?

a) Since the Second World War, Massachusetts has had a tradition of strong research institutions. And, because MIT will not conduct research classified "secret" on campus, new companies have been created to take advantage of the funds available for that kind of work.

b) The birth of the computer industry in Massachusetts itself brought growth, but it also caused an awareness of the potential of emerging technologies, which helped to create an environment supportive of them.

c) Innovative financial institutions, including banks and venture capital firms, have helped the development of new companies. The venture capital industry was born in Boston in 1946 with the creation of American Research and Development, encouraged by representatives of both MIT and Harvard University.

d) The talent represented by the community of over 50 colleges and universities, and by the high-tech industries themselves, have become Massachusetts' most valuable resources.

e) Massachusetts had at its disposal both appropriately skilled labor and a supply of suitable facilities. For example, old mill buildings, vacated by the textile industry as it moved south or died out, provided inexpensive locations for new and expanding firms.

f) Its milieu is an essential ingredient of Massachusetts' success. Massachusetts is an attractive place to live and work.

Firms develop in Massachusetts not by design but because of the combination of institutions, traditions, and resources that encourage them to grow. The presence of research institutions like MIT are only a part of the formula.

MIT's Tradition of Entrepreneurship

MIT was founded in 1861 as an alternative to traditional liberal arts universities based on the European model. The premise was to educate young men and, shortly thereafter, young women, by maintaining a close association with industry and the concrete problems encountered there.

Close collaborations with industry were common. Alexander Graham Bell made MIT his first stop after disembarking in Boston, and the first long distance telephone call was made near a corner of the campus. The process of canning food was made scientific in MIT's laboratories in 1895. In 1948, E.V. Murphree, an alumnus, then head of Esso, asked MIT to develop a way to facilitate communication between industry and the faculty and staff. The Industrial Liaison Program, a formal linkage between participating organizations and MIT, was the result. Other formal and informal mechanisms abound.

MIT's business is education. Because it attracts top students from all over the world, MIT represents a brain power magnet to the State. Because Massachusetts has a favorable milieu, many students remain there following graduation.

Learning by doing is a strong element of the education provided by MIT. More than 2.3 of the 4 500 undergraduate students are engaged in research through the Undergraduate Research Opportunities Program. All 5 000 graduate students work on research as part of their academic program. The number of graduate students, who outnumber undergraduates, is one of MIT's greatest strengths.

MIT is a private university. The 1 000 faculty members and 2 200 full-time professional research scientists at MIT manage an annual research budget of nearly $300 million. Each year faculty members are responsible for the procurement of an average of one-third of a million dollars of funding and for the administration of the associated research activities. In other words, each faculty member can be seen as an entrepreneur who manages a $0.33 million research budget. Generally, 80 per cent of the budget is provided by the federal government and 15 per cent is provided by industry. In engineering and science, the figure provided by industry is almost 40 per cent.

MIT has not consciously tried to attract entrepreneurs, but the spirit of the institution emphasizes entrepreneurship. Part of the phenomenon may have to do with the "contagion" factor: a faculty member who recently co-founded a software firm analyzes his motivation to do so by explaining that he had observed his students and colleagues succeed in their ventures, he was reaching his mid-thirties, and the pressure to found a company was irresistible.

Why Does Industry Work with MIT?

In addition to their research and teaching, MIT faculty are expected to spend one day a week consulting with industry in order to provide assistance with current problems. In return, they remain aware of the needs of industry, learn of appropriate employment opportunities for their students, and augment their academic salaries which would not otherwise be competitive with what they could earn outside the University.

MIT does not engage in proprietary research for companies in the sense of giving companies exclusive access to the work done; it insists on making research available in the long run to everyone. The academic calendar and degree cycles take precedence over industry's desires for quick product or process development. Nevertheless, there are unique benefits for companies that work closely with MIT. They not only gain access to the latest technological advances, they also gain an entreé to the international network of research institutions with which MIT is associated.

MIT's Links with Industry

Since the mid-1970s there has been an increase in activities with industry at MIT. The key to their success is the whole-hearted participation of the faculty. Without it, neither informal linkages nor formal programs will succeed. The following summarizes some of the alliances with industry used at MIT.

The Enterprise Forum uses a format of monthly presentations by entrepreneurs before a panel of experts, or small dinner meetings, to provide a channel of information about management, financing and technical issues. Started by the MIT Alumni Association more than ten years ago, there are now Enterprise Forums operating in many cities in the United States and Europe. Attendance by venture capitalists at meetings is legion.

The Engineering Internship Program and other departmental cooperative work-study programs provide advanced undergraduate students with the opportunity to gain valuable work experience while completing their degree requirements. The firms involved not only gain contacts with potential full-time employees but also have the benefit of sometimes surprisingly productive output from workers who have not yet learned that certain things "can't be done."

Sponsored Research continues to be an important industry link at MIT. Industry accounts for 15 per cent, or $45 million, of MIT's annual research budget. In addition to traditional research projects directed toward the interest of the sponsoring company, a new kind of research program has been developed by the faculty in the past ten years. These programs solicit research support from a group of companies which together fund a set of related projects. By funding advanced generic work through such an informal consortium, the firms are able to leverage their investments. For example, work in ceramics processing or internal combustion engines is supported by groups of about ten companies, each contributing approximately $50 000 annually for access to the results of a half-million dollars' worth of research work.

MIT's Summer Session offers special one or two-week courses for the private sector on specific subjects drawn from the faculty's teaching and research expertise. Summer programs are tailored to address areas of particular interest to industry. They provide attendees with the opportunity to update their skills, to become acquainted with the latest technology and techniques, and to meet faculty and other industry representatives.

Visiting Scientists and Engineers, and Adjunct Faculty programs have been shown to be the most effective means of technology transfer and implementation. Often in conjunction with sponsored research, companies finance researchers to spend a half-year working at MIT. To encourage the formal transfer of expertise from industry to MIT, the University employs adjunct faculty who have worked extensively in industry and who impart their knowledge to MIT students and other faculty.

Technology Licensing is actively pursued by MIT to develop its technological ideas and to permit MIT to share in their commercial success. So far, the most lucrative patents held by MIT have been the magnetic core memory developed by Jay Forrester and the process for the commercial production of penicillin developed by John Sheehan.

MIT's Industrial Liaison Program

The Industrial Liaison Program was started in 1948 and it remains the primary formal program with industry at MIT. Its mission is to create and strengthen partnerships with industry. Under the program, the Industrial Liaison Officer arranges formal and informal contacts between faculty and company clients on subjects of interest to the companies. Clients also receive a variety of publications, such as the MIT research directory which lists 3 000 projects per year, the monthly MIT report which summarizes the work being carried out, and preprints and working papers. The program sponsors as many as 15 symposia and 40 half-day seminars each year which highlight research at MIT.

The Industrial Liaison Program was the first formal, university-wide activity of its type in the world. Membership has grown from 120 in 1975 to 300 in 1988. Program clients account for three-quarters of worldwide research and development investment. Among its members are also a number of government agencies concerned with economic and technology development, such as STU in Sweden, TEKES in Finland, and the Austrian Federal Economic Chamber of Commerce.

Key to the success of the program are: the complete cooperation of the faculty, research and expertise of value to industry, top quality MIT professional staff to perform the linkages with industrial clients, and high level contacts in the companies.

Clients view the program in a variety of ways, including as an extension of their research and development investment, as a way of leveraging that investment by gaining access to all $400 million worth of research at MIT, as part of their strategic planning and environmental scanning operations, and as a way of keeping senior management informed of the latest activities in key areas of research, engineering, and management.

The Industrial Liaison Program's approach to working with industry does not guarantee positive results for either the institution or its environment. MIT has found it to be successful, however, both for the university and for the economy of the area.

Ms. Bloomquist is the Associate Director of MIT's Industrial Liaison Program.

NOTES

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PART V.

MECHANISMS FOR FINANCING ECONOMIC DEVELOPMENT

Chapter 18

Introduction to Part V:

Venture Capital and Community Renewal

American mechanisms for funding economic development appear more efficient than those in Europe, especially mechanisms for financing employment-generating new businesses. But this vitality is due less to the traditional financial actors than to certain types of investors who are very active in the United States, but very few on the ground in France or other European countries.

In fact, American bankers are disinclined to take risks in financing new entrepreneurs. The American capital market and the regulatory systems governing banks militate against such risk-taking. But family and friends, other investors, both public and private, and risk-taking venture capital firms take up risks that the banks do not. They finance new entrepreneurs and contribute to economic development.

Informal Sources of Venture Capital

Europeans save more than Americans, but they much prefer institutional investments to financing a neighbor's new business. The opposite is the case in the United States. It has been estimated that as much as 80 per cent of the $45 billion of equity capital invested each year in business creation comes from friends, family, and associates. Tax incentives are an important reason for this phenomenon, particularly limited partnerships, which unite investors and entrepreneurs while sheltering certain profits from tax liability.

In Chapter 21, Professor Wetzel discusses the role of "business angels", an informal network of some 250 000 private investors who have capital to invest and sound business experience. The funds of the business angels amount to twice those of the professional venture capital community. They invest in some 20 000 businesses every year, compared to 3 000 for the established professionals, in sectors which are little covered by the venture capital companies, notably by providing seed money for small business start-ups.

Venture Capital Professionals

Even though most business creation financing comes from informal networks, the importance of venture capital professionals in the United States must not be underestimated. According to the European Venture Capital Association, the European venture capital market is barely half the size of the American market. (In the same context, the English venture capital market is seven times larger than in France.) The relative sizes and growth rates of the French and American domestic markets may partly account for the differential. Other frequently advanced reasons include the presence in the United States of large pension funds which invest in ventures, the preference of French entrepreneurs to under-capitalize start-ups in order to retain their independence, and the more developed system of technology transfer from research centers to businesses in the United States.

American venture capital is quite sharply concentrated geographically. It is mainly found in sectors with a high technology capacity -- California, Massachusetts, and New York account for over 70 per cent of total funds. And it has for quite some time been concentrated in computers, electronics, and high technology industries. Recently, however, venture capital companies have been increasingly turning to the medical sector, genetics, and biotechnology. Recent trends in the professional venture capital community are discussed by Mr. Lamond in Chapter 20.

American venture capitalists make their money from capital gain upon sale of their shares in the enterprises they finance. In France, equity capital institutions often try to find ways of obtaining interest on the capital invested, through the use, for example, of preference shares and convertible bonds. They tend to be sleeping partners, considering it undesirable to take part in the life of firms they invest in or to sit on their boards. American venture capitalists, by contrast, are often very active in the firms they help create, and take a decidedly "hands on" approach to them.

American and French venture capitalists differ appreciably in their professional origins. In France, they come mainly from the world of finance, whereas in the United States they are more often drawn from the business world. This difference is important: American venture capital professionals are fully involved in the success or failure of the firm. French equity capital professionals, notably those from the public and semi-public sectors such as regional holding institutes, industrial finance companies, and regional development companies, adopt the passive role of the banker.

Cities and States Finance the Gaps

The venture capital networks in the United States, informal and professional, leave gaps in the funding of local development which local authorities fill. Michigan is well in the lead in doing so, with the Michigan Strategic Fund as described by Peter Plastrik in Chapter 19. The various investment funds set up by American local authorities generally share the following features:

a) The funds intervene in sectors where the private capital market does not invest. For example, they fund projects for ethnic minority business development and for particularly depressed communities. They provide seed money to start-up businesses, and financing in the "middle risk" market which private professionals generally consider too risky.

b) The funds systematically use "leverage" in their investments, deploying public funds to stimulate private investment in economic development. The importance of leverage is strongly emphasized in the chapters that follow.

c) The funds are managed by highly competent, highly professional people. Local authorities do not hesitate to resort to private consultants. The managers of the local authorities' finance companies are often drawn from the private sector and are paid accordingly.

In Chapter 22, Ronald Grzywinski describes how a deteriorating Chicago neighborhood was revived through the efforts of the local bank. The bank's professionalism is highlighted in the entrepreneurial approach it took in its revitalisation program which involved cost management and evaluation of results.

The funding of local development in the United States, particularly with respect to investment in the social sector, generally reveals an entrepreneurial attitude not usually found in France. Local development in the United States uses a form of management which is based more on business investment than the redistribution-management of the welfare state. American local funding mechanisms may in some cases be marginal, but they use approaches that should be considered in European countries.

It must be remembered, finally, that the federal government plays an important role, largely through Small Business Administration Programs, some of which have been in place for thirty years. Although cuts have been made in federal local development funds, programs have remained effective because of the decentralization of their management and because of the systematic use of leverage.

Hugues Sibille

Chapter 19

The Michigan Strategic Fund

Peter Plastrik

The Michigan Strategic Fund (MSF) is a state agency which, in less than 30 months, built a unique partnership between government and the private sector. It is stimulating an unprecedented availability of growth financing for the State's most important sources of job creation: small businesses, entrepreneurs, and technology-based companies. It administers a fund of $200 million, allocated to it by law for the long term.

The MSF has been heralded by INC magazine as the "most sophisticated financing agency in the nation", and many other states are actively adopting the MSF's innovative programs.

The most important measure of the MSF's success is in Michigan's private financial marketplace. Investors of all types, banks, venture capitalists, pension funds, corporations, wealthy individuals, and the federal government are responding to MSF-generated investment opportunities and are making financing available for Michigan enterprises. More than two dozen banks have made a total of $6 million in loans to 75 small businesses, and more loans are forthcoming. In Kalamazoo, a new financial institution, Arcadia BIDCO (Business and Industrial Development Corporation), is investing $6 million in Western Michigan businesses, and more BIDCOs are being formed across the State. Three new seed capital companies, one of the largest pools of high-risk capital in the nation, are providing more than $10 million in start-up capital to entrepreneurs with good ideas.

A $14 million federal contract is establishing Michigan as the home of a high-speed communications network which will link the nation's university and industrial scientists. And other high-tech prizes have been won. A new research and development consortium of American manufacturers, the National Center for Manufacturing Sciences, has located in Michigan, and Michigan has been selected as the site for a National Aeronautics and Space Administration Center to commercialize space technology.

The MSF has funded two national-class research and development facilities, the Industrial Technology Institute and the Michigan Biotechnology Institute. Those facilities have built strong technical expertise and have expanded industrial connections in their pursuit of technology applications which can modernize industry and develop new products for new businesses.

The Reasons for the MSF's Success

Clearly, the MSF's programs are generating a positive response from the marketplace. Three factors account for its success:

First, the MSF is in itself a public/private partnership, with a majority of its board of directors drawn from the private sector.

Second, the MSF had sufficient initial funding to allow the board of directors to take a long-term, innovative perspective. While quick successes were important and have been achieved, programs could be initiated which required a number of years to have substantial impact.

Third, the MSF has focused its activities from the beginning on supporting the development of small businesses and entrepreneurs. A clear and sustained strategy is preferable to trying to be all things to all interests.

The MSF's Philosophy

The philosophy of the MSF was set in the early days by the board and rests on three fundamental principles:

First, use leverage to achieve substantial impact with the MSF's resources. Relative to Michigan's economy, the MSF's resources are small: billions of dollars of financing occurs annually in Michigan. The MSF board concluded that impact could only be achieved if large amounts of private sector dollars were leveraged by the MSF's investments. While most traditional government programs at best leverage $3 of private financing for $1 of public funds, the MSF's programs are designed to achieve leveraging ratios of 20 to 1, 40 to 1, and sometimes even more.

The MSF's second guiding principle is to identify gaps in the financial marketplace and help to fill them, but to avoid using public dollars where private dollars can be used. Rather than substituting for available private capital, the MSF focused on how and where to channel private financing to support Michigan businesses. It identified two critical market imperfections: seed or pre-venture capital, and middle-risk capital, the market between equity venture financing and bank debt financing. In Michigan, bankers and venture capitalists are sources of substantial amounts of business financing. Almost non-existent is the seed capital market which gets entrepreneurs started and ready for venture capital financing. And very underdeveloped is the middle-risk market for financing companies -- too risky for banks and without the growth potential sought by venture capitalists.

Third, the MSF endeavors to build financial institutions, it does not just "do deals". An effective, long-term strategy to fill capital gaps focuses on building a comprehensive private financial infrastructure to serve business needs. The MSF uses public capital to stimulate the creation or enhancement of privately controlled and capitalized financial institutions.

In the United States, many federal and state government agencies had become direct lenders to businesses. This meant that government bureaucrats analyzed business plans and made credit decisions. For a number of reasons, the MSF did not want to be in the lending business: credit decisions are better made by bankers than by government. Equally important, the MSF was not interested in building businesses that could not meet private market tests. Publicly financed companies are in many cases doomed to failure in the long term. The MSF's approach creates the real possibility of establishing new, market-driven institutions that will exist for decades, if not for centuries.

The MSF's initial funding was provided by the State Legislature which earmarked part of Michigan's oil and gas lease sale revenues for the MSF. The MSF used the anticipation of those revenues to float a bond to provide the initial capital for its programs. With its funding in place, and with the foregoing principles in mind, the MSF implemented a variety of initiatives, the most important of which were aimed at building financial institutions and pursuing technology development.

Institution Building Programs

To remedy Michigan's financing gaps, the MSF embarked on a program, unique in the country, of co-capitalizing new financial institutions, and capitalizing the extension of existing financial institutions, with the private sector making the financing decisions. The only significant restricitons placed on the institutions is that the MSF's money must be used to support businesses in Michigan and supply capital in the identified gap. The MSF created a set of programs, in effect a set of subsidies and incentives, which were designed with the participation of the private sector.

a) The Seed Capital Program

The Seed Capital Program has stimulated the development of three seed capital companies, with approximately $10 million under private management. A fourth company is in the process of being formed. Over the next three years, the seed capitalists will invest in approximately 75 Michigan start-up companies, most of which have had no previous sales and which require business plan preparation, management team building, market analysis -- all the procedures that most venture capitalists insist on companies' having completed before they will even consider investing.

Private funding for the seed firms came from diverse private investors, such as wealthy Michigan individuals and corporations, and venture capitalists in New York and California. The companies' managers are equally diverse: they are business consultants, former venture capitalists, former bankers. They are part of a nationwide investment network which will be able to provide follow-on financing for the companies they are helping to establish.

The MSF has no voting or decision-making rights in the seed capital companies. Each company received a ten-year $2 million loan. In return, each company raised $2 million of private equity investment.

Seed capital did not exist in Michigan in such a form before the MSF instituted its program.

b) The Capital Access Program

The Michigan banking community has $16 billion of commercial and industrial loans. Yet most small businesses complain that bankers refuse to take any risk. In fact, banks are not supposed to take much risk -- by both financial and regulatory design, the premise of the banking community is low risk and low return. It is the way government regulatory bodies prefer banks to operate, and the way banks' debt to equity levels are generally designed.

Venture capitalists' success, on the other hand, is based on an entirely different financing structure. They are equity-based, seeking high risk and high return. The MSF believed that in the middle-risk category there were thousands of Michigan companies that could not obtain financing but which were viable business propositions if the financiers' risk could be made commensurate with the expected return.

The Capital Access Program is designed to permit banks to take slightly more risk than is usual in their lending portfolios, with the approval of federal and state regulators. In its first year, the program attracted the participation of more than 50 Michigan banks, resulting in 70 loans being made to businesses, most of which had fewer than 20 employees. The cost to MSF to stimulate those loans, which totalled $5.5 million, was less than $1 for every $17 lent by the banks.

The MSF does not instruct the banks about what loans to make, what interest rates to set, or how much insurance to buy for the loans. It plays a passive role and has no bureaucracy.

c) The BIDCO Program

The BIDCO (Business and Industrial Development Corporation) Program has successfully created one BIDCO, which over the next decade will provide more than $50 million in middle-risk financing in Western Michigan, and has made MSF investment commitments to three other BIDCOs which are actively seeking $17 million in private capital. The organizers and the business strategies of these and other planned BIDCOs demonstrate enormous diversity, as do their sources of private capital: individual, corporate, and institutional investors. The roots of this new financial industry are taking firm hold in Michigan.

The BIDCOs are similar to private investment companies, intended to respond to the middle-risk market. BIDCOs are equity capitalized, but they are able to leverage their equity one to one, two to one, and sometimes even three to one. The MSF has offered to put as much as $2 million in equity into any BIDCO that can raise $4 million itself, and it has allocated $24 million to the program. Commitments have already been made to three BIDCOs. The first in Michigan -- in Kalamazoo -- recently started with a $6 million capital base, $4 million of private capital and $2 million of public capital. It will invest in small manufacturers in Western Michigan who are viable but who are unable to obtain bank loans. The Kalamazoo BIDCO was organized by a former area banker, a former area venture capitalist, and a professional management consultant. In one night they raised the $4 million from 103 wealthy people with whom they had done business before.

The MSF believes that over the next four to five years there will be perhaps as many as 20 BIDCOs capitalized in Michigan, with a total resource pool of as much as $.25 billion. The resource pool may be leveraged in a variety of ways -- for example, with equity leveraged by debt from banks and pension funds. Each deal the BIDCO undertakes may be done in partnership with other sources of investment, thus creating yet another round of leveraging. It is the MSF's intention, when a BIDCO has proven to be successful, to sell its stock in the BIDCO at a market rate, withdraw from it, and leave it free-standing, with nothing but private investment. That would be, in effect, infinite leverage.

There is great diversity in the BIDCO market. One BIDCO is dedicated to the advanced technology auto supply sector. The Kalamazoo BIDCO is involved mainly in conventional manufacturing companies with good prospects but without balance sheets strong enough to obtain traditional bank loans. A third BIDCO is in the turnaround market -- it is aimed at saving failing companies that need new capital and new management. The newest BIDCO, capitalized in February 1988, is contemplating investments in small businesses.

d) Minority BIDCOs

Most small businesses that are not initially financed by seed or venture capital are started with money provided by family and friends. But minority communities often do not have sufficient personal resources to capitalize business ventures. The MSF has initiated a program not simply to provide loans to minority businesses but to help capitalize a minority-owned financial institution that will create a track-record of loans made to minority companies.

Traditional minority institution-building programs provide government money to minority institutions with the proviso that the money must be used to finance minority companies. The MSF has adopted a different scheme under which it provides the initial capitalization with no restraints on the choice of companies financed, but with a strong incentive for the minority institution to finance minority businesses. Under the MSF's approach, the minority BIDCO was required to provide $500,000 in equity, at least half of which had been raised from minority individuals, and a complete and satisfactory business plan and management team. In exchange, the MSF offered a ten-year loan of as much as $3 million. The MSF further required that the minority BIDCO find a source of senior debt in the private sector to match the State's $3 million, and $3 million in debt from a bank or pension fund -- an initial capitalization of $6.5 million.

In addition, if the minority BIDCO investments in minority businesses or in businesses in distressed areas result in new jobs being created or the companies' sales being increased, the MSF will convert part of its loan into a grant. Conceivably, therefore, even if the minority BIDCO only breaks even on its investment strategy over several years, it could convert the MSF's loan entirely into a grant and increase its equity base from $500 000 to

$3.5 million, to be distributed among the original stockholders -- a powerful incentive to raise the requisite initial $500 000 in equity.

When the program was introduced last year, three proposals were submitted. Each has raised the required $500 000, largely from minority individuals, each has a business plan which with some technical assistance can be made viable, and each is recruiting a management team.

Technology Development Programs

The MSF's "Centers of Excellence" program has provided substantial initial funding for research and development centers designed to enhance Michigan's strengths in durable goods manufacturing and renewable resource sectors such as agriculture and forestry. The centers -- the Industrial Technology Institute, Michigan Biotechnology Institute, and the Metropolitan Center of High Technology, in Detroit -- have selected specific technology niches in which to specialize in order to develop a comparative advantage for Michigan.

In addition, the MSF has provided funding for research and development consortia, usually combinations of private businesses and a number of university and other non-profit institutions, particularly those that appear to be of national scale. The consortia are designed to attract substantial federal and corporate financing. The Centers of Excellence, research universities, and consortia help to establish within the State a fund of basic and applied research and development to nourish future business development.

The MSF's Relationship with the New Institutions

The absence of government intervention was the reason for the private sector interest in the MSF's programs. If the private sector had foreseen that the MSF would have a management voice in the new institutions, they would never have come into being. There are, however, two ways in which the MSF can guide the new institutions: First, the investment contract entered into with each institution includes provisions which must be observed to avoid default. Second, the MSF has full observation rights, as though it were an active partner.

The state government is the source of many of the transactions entered into by the new institutions. A considerable number of inquiries about business financing are handled daily by the public authorities. Those inquiries are directed to the seed capitalists, BIDCOs, and bankers who are using the MSF's programs.

The MSF has built strong relationships with the new institutions and has provided them with considerable technical assistance. Even though most of the companies capitalized by the MSF pay their senior staff as much as 100 per cent more than the public employees who designed the programs and made the companies possible, the MSF is nevertheless composed of a team very knowledgeable about the markets in question. The MSF is motivated by public policy rewards, not by financial rewards. And the private sector has learned to respect the intelligence available in the public sector, the intelligence that created the programs.

Conclusion

Most of the MSF's programs have never before been attempted in the nation. They continue to be run by this infant institution which is continuing to develop new initiatves. A unique aspect of the MSF, and perhaps its greatest strength, is that a great diversity of financing programs are housed under one roof.

The signs testify to the success of the MSF's programs: First is the private market response. The private sector has cooperated in each of the MSF's programs, money has been provided and businesses are being financed. Second, other states are beginning to adopt the MSF's programs.

Mr. Plastrik is the President of the Michigan Strategic Fund.

Chapter 20

Venture Capital:

The Engine of Economic Growth

Pierre Lamond

What is the role of venture capitalists in financing the growth of companies in the United States? During the past thirty years, venture capital has evolved into a business in its own right, a business that builds businesses. Venture capitalists are not bankers, who lend money to companies and passively collect interest on the loans. Like entrepreneurs who start companies, venture capitalists are shareholders who consider themselves a part of the companies they finance. Venture capitalists take an active part in the formation, development, and expansion of young businesses.

Venture capital is not new to the United States. Some venture capitalists financed companies before World War II -- wealthy individuals, such as Laurence Rockefeller who started Eastern Airlines and MacDonnell Douglas. Today's venture capitalists are firms, like Sequoia Capital, who invest money entrusted to them by large institutions such as universities, foundations, and pension funds. When investments are successful, the firms retain a share of the profits.

Venture Capital and Economic Growth

Venture capital firms have spawned many of the most important industries and companies to emerge in the United States since the 1950s: Digital Equipment, the company that created the mini-computer business; Apple Computer, which was the start of the personal computer industry, and in which Don Valentine of Sequoia capital was originally involved; Genentech, which lies at the center of the biotechnology industry; Intel and Advanced Micro Devices, which have helped create the worldwide market for silicon chips; and Cray Research, which makes the most powerful computer in the world. Behind almost every significant new technology to emerge in the United States during the past twenty years is a venture capitalist.

Venture capital is not exclusively dedicated to technology companies. Federal Express, which pioneered the overnight package delivery business, was financed by venture capitalists. Some venture capitalists concentrate on starting consumer goods and retail operations. Sequoia Capital is exploring the possibility of investing in an insurance company and an airport shuttle service.

Venture capital has become a major force in the development of the American economy. In 1987, between $3 and $4 billion was entrusted to venture capital companies. To put that in perspective, General Motors, the largest industrial company in the world, spent $4.1 billion on research and development, IBM spent $3.9 billion, and AT&T, the company which still dominates the vast American telephone system, spent $2.2 billion.

Venture capitalists manage far more money today than they did ten or fifteen years ago. In 1979, only $300 million was invested in venture funds. In 1982, that figure had risen to $1.8 billion. Since 1980, a staggering $20 billion has been committed to venture capital funds. The U.S. General Accounting Office estimates that between 1970 and 1979, about $1.4 billion was invested in some 1 300 companies. These companies, between 1980 and 1989, should produce over $500 billion in sales. Every dollar invested by venture capitalists helps to produce $400 in sales. And every $750 invested by venture capitalists produces a new job.

Changes in Investment Strategy

Recent years have witnessed changes in the way venture capitalists invest their funds. A few firms have been enticed by the prospect of conducting leveraged buyouts and have been investing more in this area. Others have been buying operations like television stations and cable channels. But "pure" venture capitalists have been putting a larger proportion of their portfolios into investments in the medical and health care field. About 12 per cent of all venture capital was spent in this area in 1986, compared to about 6 per cent in 1981. During the same period, the proportion of portfolios directed to investments in the computer business declined. In 1982, for every $100 of venture capital, $42 was invested in computer companies. In 1987, that figure had dropped to $29. Nevertheless, the greater portion of venture capital still goes to companies in the computer, communications, and medical fields. And it is in those field that most future jobs will arise.

Strong Regional Differences

An entrepreneur in pursuit of finance in the United States would be well advised to go to San Francisco or Boston. About 44 per cent of all monies handled by venture capitalists is invested by firms based in California. Massachusetts firms account for another 13 per cent. Although there are some notable venture-backed companies in Texas and the Pacific Northwest, California and the Route 128 area around Boston are the most fertile parts of the country for both capital investment and job creation.

Different Types of Investments

There are venture capitalists in the United States to finance every stage of a young company's growth. Some firms choose to invest when the young company might only consist of three people and an idea. Other firms prefer to invest when the company is more mature and already has a product and some sales. There are a few firms, such as Sequoia Capital, that are prepared to finance every step of a company's growth.

Sequoia Capital has invested sums as small as $25 000 to help in the preparation of a business plan. But it is also willing to invest $5 million in an expanding company that has rapidly growing sales. When Sequoia Capital invests in a company where the management team is incomplete, when it is not known whether the product is viable or whether there is a market for it, Sequoia prefers to buy a large percentage of the company. But when the company is more mature, Sequoia Capital is prepared to accept less for its investment. The company's business revolves around the risk/reward equation: the greater the risk it accepts, the larger the reward it hopes for. When companies are successful enough to raise money from public investors, Sequoia Capital's financing role usually stops, though it frequently maintains close connections with the company.

Venture capital is not the only financing young companies need - it supplies the foundation on which other sorts of financing can be layered. When Sequoia Capital decides to invest in an enterprise, it usually invites other members of the venture capital community to participate in the investment. That way, if the company encounters difficulties or needs further investment, the burden is more widely spread.

In the United States, once a reputable venture capitalist has financed a company, investments can often be attracted from other sources as well. For example, large corporations interested in new technologies often invest in young companies. Leasing companies and commercial banks finance purchases of equipment or help with the build-up of inventory as companies grow. Some state governments, Michigan in particular, seek to invest in companies with job creation potential. Representatives of foreign governments invest in companies they believe will help to bring technology and employment to their countries.

Traditional bank financing generally comes late in a new company's development because banks' lending criteria are based on historical achievement and a strong balance sheet. In their early stages, the companies that Sequoia Capital finances do not qualify for bank loans.

Sierra Semiconductor offers an example of the way a company can finance itself from a venture capital base. The company was started in Sequoia Capital's office in 1984, and in 1988 should sell about $50 million of silicon chips. During the last three years, Sequoia has helped to raise over $100 million for the company, $35 million of which was provided by venture capitalists. Borg-Warner, a very large American company, has also invested in Sierra. The governments of Singapore and the Netherlands have invested in Sierra, and in return the company is building plants in Singapore and Holland. Above all, Sierra now has close ties with several leasing companies and banks.

It is not a criteria to be an American in order to get backing from a venture capitalist: Sequoia Capital has partners who are Danish, Swiss, and British. It has invested in companies run by English, French, Germans, Indians, Pakistanis, Swedes, and even the occasional American.

Mr. Lamond, French by origin, is the General Partner of Sequoia Capital, in San Francisco.

Chapter 21

Informal Venture Capital: Business Angels

William E. Wetzel, Jr.

Entrepreneurial ventures require access to capital, venture capital in particular. Consequently, the performance of the venture capital markets is a matter of concern to a society that increasingly depends upon entrepreneurs and venture investors for its economic vitality. The market for venture capital consists of three major segments: the public equity market, the professional venture capital market, and the market for informal venture capital.

The public equity market and the professional venture capital market are visible, efficient, and well understood. The informal venture capital market, on the other hand, is often misunderstood. It is composed of a virtually invisible population of individual investors who provide equity-type financing for entrepreneurial ventures of all types, including those that ultimately raise funds from professional venture investors or the public equity market. But despite their low profile, wealthy individuals -- "business angels" -- appear to represent the largest venture capital resource in the United States.

The Profile of the Business Angel

The informal venture capital market is composed of a diverse population of individuals of means, many of whom have created their own successful ventures. In general, these business angels share the following characteristics: their net worth is over $1 million and their annual income over $100 thousand; they have substantial business and financial experience and can evaluate the merits and risks of prospective investments; they are unaffiliated with portfolio ventures; and, finally, they are willing to take substantial financial risks and to commit funds for extended periods of time to earn substantial returns.

There are no directories of individual venture investors and no public records of their investment transactions, but clues to the scale of informal venture investing can be found.

In 1986, U.S. News and World Report reported that the 1985 U.S. population included 833,000 millionaires and that the number would exceed one million by the end of 1986. Thus, millionaires compose less than 0.5% of the U.S. population. The net worth of 95% of U.S. millionaires is between $1 million and $10 million. The article adds:

a) "The typical millionaire is a self-made entrepreneur in his early 60s -- fewer than 10% are under 40. He works 10 or 12 hour days and, more frequently than not, his business caters to the ordinary needs of ordinary Americans."

b) "The average annual income of millionaires is $121,000, of which three fourths comes from earned income."

c) "80% of American millionaires come from middle or working-class families."

d) "In fact, 85% of America's millionaires own their own business or a share in a private company."

The Forbes Four Hundred (1986) richest people in America represent a combined net worth of about $156 billion. Their average net worth is $390 million and the net worth of the 400th mega-millionaire is $180 million. Compared to 80% of all millionaires who apparently are self-made, only 44% (174) of the Forbes Four Hundred built their fortunes without benefit of a significant inheritance. The sixth wealthiest individuals on the Forbes list are all self-made and represent a combined net worth in excess of $14 billion.

In a 1986 study of consumer finances, Avery and Elliehausen found that the net worth of 1.3 million U.S. families (almost 2%) is at least $1 million. According to their data, most wealth is saved out of accumulated earnings, not inherited. The study also revealed that 311,000 families (37% of the top 1% of U.S. households) have invested $151 billion in non-public businesses in which they have no management interest. The nature of these investments was not discussed by the authors. If one third could be described as venture financing, existing informal venture investments are around $50 billion.

Research conducted by Applied Economics Group, Inc. (AEG) in 1986 provides other clues to the supply of informal venture capital. AEG examined how and where small firms in several regions of the United States obtain equity capital for start-up and growth. An extrapolation from AEG's results suggests that there are about 345,000 informal investors in the United States, an inference not inconsistent with Avery and Elliehausen's data. AEG estimates the median net worth of informal investors at $750,000 and their median family income at $70,000. According to AEG's data, informal investors commit some 10-24% of their net worth to venture investments. If there are 345,000 informal venture investors in the United States with an average net worth of $750,000 and with 10-24% of their net worth available for venture investments, the aggregate informal venture capital pool is between $25 billion and $62 billion.

The Investments

The demand side of the informal venture capital market is almost as elusive as the supply side. The ventures funded by individual investors appear to fall into two broad categories. The first includes technology-based inventors and start-up firms of all types requiring less than $1 million of seed capital. A few of these ventures survive and grow fast enough to become sustained companies in a short period of time, five years or less. These high potential ventures typically attract second and third round financing from professional venture capital firms before being acquired by a larger company or undertaking a public stock offering.

The second category is made up of established, privately-held firms that are growing faster than internal cash flows and retained earnings can support. Seldom can even the most profitable firms rely exclusively on retained earnings when growth rates exceed 25% per year. The most dynamic small firms are growing at annual rates exceeding 100%.

An Enormous Reservoir of Capital

Available information suggests that the scale of the informal venture capital pool is vast. If the average net worth of millionaires is between $1 million and $2 million, then, excluding borrowed funds, the total wealth controlled by the one million or more U.S. millionaires is between $1 trillion and $2 trillion. If the average millionaire commits 10% of his or her net worth to venture investing, the total informal venture capital pool is between $100 and $200 billion. If only one fourth of U.S. millionaires has any interest in venture investing, the pool of informal venture capital controlled by these 250,000 individuals lies in the $25-$50 billion range, about twice the capital managed by professional venture investors.

It appears that each year over 100,000 individual investors finance between 20,000 and 50,000 firms for an investment totalling between $5 billion and $10 billion. The typical firm financed by angels raises about $250,000 from three or more investors. The typical investor provides between $25,000 and $50,000 per firm, about half in the form of equity and half in near-equity (loans and loan guarantees). During 1985, professional venture investors financed about 2,500 firms for a total of about $2.5 billion, an average of about $1 million per firm.

Capital Market Efficiency

In the minds of entrepreneurs, perceptions of gaps in the capital market endure. Perceived capital shortages include product development financing for technology-based inventors, start-up and early-stage financing for ventures that fail to meet the size and growth criteria of professional venture investors, and equity financing for closely-held firms that are growing faster than internal cash flows can support.

The capital gap folklore is based on the observable behavior of financial institutions, but it overlooks business angels. Angels not only exist, they tend to invest in precisely the areas perceived as gaps in the capital markets by entrepreneurs.

But, despite the apparent size of the informal venture capital pool, the effect of capital gaps can be created when markets fail to function efficiently. Modern financial theory rests on assumptions of efficient markets -- markets in which information about sources of funds and investment opportunities is fully and freely available to buyers and sellers of capital. The evidence suggests that this necessary condition is far from fulfilled in the angel segment of the venture capital markets. In the absence of efficient markets, capital cannot flow from less productive to more productive investment opportunities.

In a 1975 study, Bean, Schiffel and Mogee found little evidence that technological innovation by new or small firms is impeded by an inadequate supply of capital. They noted, however, that the majority of venture capital firms did not fund start-up companies. The pattern still prevails: reports in Venture Capital Journal and Venture Magazine's index of venture capital activity in 1986 indicate that about 13% of the funds disbursed by all venture capital firms in 1985 were seed or start-up investments.

Networks

Of the many studies describing the channels through which information about investment opportunities in new and/or small companies is transmitted to individual investors, none fails to cite the importance of informal networks of trusted friends and business associates.

In a study of informal risk capital in New England, Seymour and Wetzel collected data from 133 individual investors who fit the description of business angels. These investors reported risk capital investments of over $16 million in 320 ventures between 1976 and 1980, the average size of each investment being approximately $50,000. Business associates were cited by 52% of those sampled as a frequent source of investment opportunities, 50% cited friends, and 41% cited active personal search. The next most common source, investment bankers, was cited as a frequent source by 15% of the sample. All other sources, including business brokers, commercial bankers, attorneys and accountants were insignificant. Four out of five of the investors declared themselves totally dissatisfied with existing channels of communication between entrepreneurs and individual investors and 58% of them expressed strong interest in a service that would direct investment opportunities to their attention.

Venture Capital Network -- An Experiment In Capital Formation

Perceptions of the scale and inefficiency of the informal venture capital market, combined with the significance of entrepreneurial ventures to the vitality of the U.S. economy in general and the New England economy in particular, prompted the formation of Venture Capital Network, Inc. (VCN). VCN is a not-for-profit corporation managed by the Office of Small Business Programs of the University of New Hampshire. Its essential purpose is to introduce entrepreneurs to individual venture investors and to venture capital firms interested in early-stage financing.

Financial support for VCN has been provided by the Business and Industry Association of New Hampshire, the University Center for Technical

Assistance, the U.S. Economic Development Administration, the Ellis L. Phillips Foundation, and a group of sponsoring organizations.

Entrepreneurs most likely to benefit from participation in VCN are those who require between $50,000 and $750,000 of equity-type financing. They are often referred to VCN by accountants, attorneys, bankers, and venture capitalists. Over 80% of the ventures seeking financing through VCN are under five years old. VCN investors are primarily affluent individuals.

VCN maintains a confidential data base of Investment Opportunity Profiles submitted by entrepreneurs and a confidential data base of Investment Interest Profiles submitted by investors. Using a two-stage process, VCN submits to investors those investment opportunities that meet their screening criteria. Both parties remain anonymous throughout this process. At the conclusion of the process, entrepreneurs are introduced to those investors interested in pursuing an investment opportunity. VCN's role terminates with the introduction of entrepreneurs and investors -- it is an information service only, and it neither evaluates nor endorses the merits of investment opportunities.

Between July 1984, when it began operating, and June 1986, VCN arranged more than 1,000 introductions for over 200 entrepreneurs from 30 states and over 300 investors from 33 states.

VCN provides assistance to not-for-profit organizations replicating VCN throughout the United States -- in Indiana, New York, St. Louis, Atlanta, and even in Ontario, Canada. Many other groups are exploring the possibility of creating VCN counterparts. Ultimately, VCN expects to establish VCN-International, a service that will link regional networks, thereby contributing to the efficiency of the international market for informal venture capital.

VCN is still an experimental project. While early results are encouraging, it can scarcely be said that it has had a major impact on the flow of informal venture financing in New England. But several lessons are emerging. VCN's experience confirms the diverse nature of the informal investor population. Informal investors are difficult to reach. Nor do new concepts sell themselves, they need to be carefully explained. And finally, venture investing is not a full-time occupation for informal investors. Learning the tricks of the trade takes time, and time is scarce.

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Chapter 22

Banks and Community Renewal: Chicago's South Shore Bank

Ronald Grzywinski

The Illinois Development Corporation (INDC) is a bank holding company that was established to foster a permanent renewal process in blighted neighborhoods. INDC owns and manages the The South Shore Bank of Chicago, a commercial bank organised under the banking laws of the State of Illinois and regulated also by the Federal Deposit Insurance Corporation (FDIC). In addition to the Bank, the company owns and manages a real estate development corporation, a venture capital company, a not-for-profit organization that engages in remedial education, job training, creation, and placement, and cooperative housing development. Like all bank holding companies, INDC is regulated by the Board of Governors of the Federal Reserve System. At midyear in 1986 the Corporation had total assets in excess of $130 million and capital of $6.3 million.

Chicago's South Shore

The South Shore neighborhood developed between 1910 and 1930, and in the 1940's and 1950's many considered it to be one of the most attractive communities in Chicago. The area is approximately four kilometers square, 8 miles from downtown Chicago, and houses about 80,000 people. In 1960, 100% of the residents were white, in 1970 they were 70% black, and today they are 98% black.

The South Shore has a concentration of large apartment buildings, sixty-year-old walk-ups with five to thirty-six units each. There are approximately 24,000 such units in the neighborhood, 71% of the total housing stock. It is that kind of property that suffers most in racially changing areas, and it is the primary form of housing for low and moderate income residents. Age, economic inefficiency, racial bias, deferred maintenance, poor tenant selection, unemployment, and non-availability of financing accelerate normal deterioration. Chicago loses 6,000 housing units annually, mostly walk-ups, to abandonment and demolition. Whenever such buildings have been densely concentrated, abandonment has been contagious -- like waves of dominoes, building after building has been demolished. The process becomes a powerful negative influence on community self-confidence and promotes other social problems. It is destructive, and can be countered only through large-scale intervention. Rehabilitation of an occasional building, traditional public improvements to streets and parks, a new commercial center, even multi-building housing rehabilitation projects are inadequate interventions once the deterioration process gains momentum.

The Origins of the INDC

The INDC originated in 1970 when a group of bankers working in minority small business financing began seeking ways to create a market-oriented approach to neighborhood development. They sought to create a private development corporation that could be flexible, permanent, privately capitalized, profit-disciplined, self-sustaining, relatively independent of the political process, and insulated against political change.

The new organisation had to be adequately capitalized to support not only job creation, but also housing rehabilitation, job placement, remedial education, and child-care schemes. The organizers considered it important that the managers of the development process control as many of the critical capital, credit, and talent resources as possible, and at the same time that they be able to take initiatives. They were not to be a passive, lending institution like a bank. The new organization was also intended to be able to enter into partnerships with other private investors and with government, and to release the energies of the local residents. It was important that a large percentage of the community participate.

In 1972, the organizers took advantage of a change in the federal regulations pertaining to bank holding companies which newly permitted them to invest in community development corporations if the primary purpose of the corporation was economic development for the benefit of low and moderate income people.

In considering the regulatory change, the organizers of the new development corporation asked themselves: if a bank holding company could invest in a community development corporation, why could a bank holding company not be a community development corporation? In response, they designed a bank holding company whose primary purpose was community economic and social development.

Community Renewal

INDC views all communities as living entities that are simultaneously disintegrating and rebuilding. In a prospering environment, rebuilding dominates. But when deterioration outpaces renewal and investment, blighting conditions appear, feed on themselves, and eventually lead to loss of confidence, disinvestment, deterioration, and, ultimately, abandonment. The task off the neighborhood development organization is to reestablish equilibrium between disintegration and renewal. It does this by supporting a careful blend of "top-down" and "bottom-up" rebuilding activities. In large metropolitan areas those activities often start with improving the condition of housing for low and moderate income residents and then expand to include remedial education, work skills training, job placement, small business financing, job creation, and a diverse array of economic and social development programs.

The clearest indicator of a permanent neighborhood renewal process is active investment by private and institutional investors who believe than an identity exists between their self-interest and that of the residents. While major investors always have alternative locational choices, newer, often minority investors have fewer options. Both, however, must be confident of an accelerating flow of future investment by others, financing to sustain an orderly market, and a reasonable expectation of capital appreciation. That set of conditions can induce the flow of private investment needed to rebuild a seriously deteriorated local economy. When it becomes broadly based, the process sustains itself within the market economy.

Acquisition of the South Shore Bank

Of all the possible initiators of neighborhood renewal, none better combines financial and managerial resources than a regulated, diversified, deposit-taking financial institution. If located within the community, it can be continuously knowledgeable about the neighborhood economy. Most significantly, it converts ordinary bank deposits into development credit. The availability of credit, combined with restored self-confidence, can precipitate the release of local energies, inducing residents to risk their own savings and become personal stakeholders in the future of the community. Through its non-bank development affiliates the regulated depository can invest equity capital in businesses. Others can rehabilitate real estate, operate social development programs, and attract other public and private investors. It can link residents, local government and private resources into a coherent renewal effort.

Accordingly, the INDC's plan called for the acquisition by the holding company of a commercial bank, and the organizers set their sights on the South Shore National Bank. The South Shore Bank had been chartered in 1939 and had prospered until between 1968 and 1972, when, as the neighborhood deteriorated,its deposits were reduced and its assets declined from $80 million to $50 million. The bank had applied to the Comptroller of the Currency for permission to close its office in the South Shore community and to relocate its operation elsewhere. Until that time, whenever a U.S. bank made such application, on the grounds that its neighborhood was deteriorating and the bank could no longer survive, permission was always given. But in this instance, a group of neighborhood residents opposed the application. They were successful, and the Comptroller ruled that the bank had failed to show persuasive reason for abandoning its service area.

The bank holding company took over ownership of the South Shore Bank in August 1973, by which time the bank's assets had fallen to approximately $42 million, half the resources it had held five years previously.

In the beginning, the organizers knew that no money would be available from the city government. The city government had been entrenched for a long time and did not believe that there could be any such thing as a stable, predominantly black neighborhood. The organisers also understood that the bank had to be made profitable in order for it to be used as a symbol for what could occur in the community.

In its early years INDC had to reverse a dramatic outflow of deposits from the Bank and credit and confidence from the community. It did that by simultaneously making the Bank's services competitive, organizing community meetings, extending credit, inducing participation by private mortgage insurers, inviting local residents onto its board, remodelling its facilities, attracting public subsidies to development, retraining its staff, attracting a community-sensitive housing rehabilitation company, raising investment capital for community organizations, and generally heralding the revival of South Shore. As the process unfolded the Bank attracted an intelligent but inexperienced staff that had to be systematically trained in banking and development. Thereafter, it began to make increasingly difficult loans for multi-family rental housing rehabilitation, small business start-ups and commercial district rehabilitation.

Beginning the Renewal Process

Initially, INDC possessed no development resources other than South Shore Bank, an inappropriate tool to confront the monumental task of rebuilding a substantial number of ageing apartment buildings. As a result, it worked hard to attract an experienced developer who could execute a large-scale and heavily subsidized housing rehabilitation project. This first project set a quality standard for all that followed. It demonstrated the latent strength of the rental housing market and convinced outside actors of a new reality: the economic viability of an overwhelmingly minority but economically integrated community. It also attracted the attention of a small number of local residents who had accumulated modest personal savings, who intuitively understood the market's desire for better rental housing, and who were willing to invest those savings in the expectation of future gain. Those residents were able to acquire and renovate rental properties because the South Shore Bank had similarly concluded than an adequate market existed for modestly improved but unsubsidized rental housing and was willing to lend the necessary funds. Thus, the beginning of visible renewal, and the Bank's symbolic function, sent messages to the community and to outsiders that the neighborhood was improving.

Part of the INDC's strategy included financing small business operators, in particular those who would purchase and rehabilitate multi-family buildings. In the early days South Shore Bank was the only lender willing to provide such financing. The terms of the loans generally required 20 per cent to 25 per cent of hard cash equity to be provided by the borrower, with the Bank financing 100 per cent of the rehabilitation. An agreement by the borrower to engage in rehabilitation was mandatory. Thus, the Bank's credit power was used to force rehabilitation.

Once the development process began to take hold, private investors became attracted to the community. By 1977, INDC had raised considerable additional capital and was able to obtain permission to create its non-bank subsidiaries.

Diversifying the Renewal Process

The first non-bank subsidiary created was a for-profit real estate development corporation whose purpose was to acquire, rehabilitate, and manage residential and commercial properties. There followed a venture capital organisation licensed by the Small Business Administration (SBA). Next, the organizers established a non-profit housing rehabilitation and development company primarily to benefit low-income people, but which also engaged in the "softer" side of development such as job training, job placement, and remedial education.

INDC used the non-bank subsidiaries to create an environment in which private investors would invest their own capital, and the Bank became the vehicle for financing that investment. The Bank also made loans to small business operators, using a thirty-year old SBA program, not often used by banks, which guaranteed between 75 per cent and 90 per cent of loans made by commercial banks to small businesses. That program became a valuable tool to the INDC. The Bank has earned the right to be the only preferred lender in Chicago, which means that it can now write its own guarantees at 75 per cent of the loan amount without prior permission from the SBA.

The INDC project started with $800,000 in equity. Over the years, the capital base has increased and there are currently thirty-four shareholders who fall into four major groups: individuals, national foundations, major corporations (such as Standard Oil Company of Indiana, and All-State Insurance Corporation), and major church denominations. The investors' main objectives were to promote development and to demonstrate the potential of the U.S. banking system to foster development in local communities.

According to INDC's most recent survey, approximately 75 per cent of its small operators are black, 98 per cent of whom are male, although there are some partnerships between husbands and wives. The bank's borrowers share three major characteristics: they are knowledgeable about buildings, building management and the selection of tenants. They know how to collect capital and how to save money. And they are capable of simultaneously co-operating and competing with each other, for example by working on each other's projects as subcontractors and yet competing for better buildings and better tenants.

A Viable Market Economy

The South Shore Bank successfully intervened in the neighborhood's massive deterioration process in the only way possible: it reestablished a viable market economy. As a result, many people have been willing to invest their time and money in the rehabilitation of older rental housing. They are comfortable with the relationship between risk and reward, and are confident that financing will be available in the future when they decide to sell those investments. The Bank succeeded, however, only because several critical factors were present.

INDC defined its primary business as neighborhood renewal for the benefit of existing residents. As a result, all of the Bank's actions are directed toward this objective. Because it is a highly regulated business, subject always to rigorous surprise examinations by regulatory officials, the structure of loans and the character of relationships between the Bank and its customers is business-like and apolitical.

Other institutions, including affiliates of the Bank, were also at work redeveloping the neighborhood. They initiated larger scale economic development projects and operated social development activities that reinforced and enlarged the development process. These activities include the construction and rehabilitation of retailing facilities, rehabilitation of rental and cooperatively owned residential buildings, and job training and placement for local residents.

The uncompromising focus of resources on a precisely defined geographic area, and the continuous presence in that area of responsible and professional resource managers created an environment in which each new investment added value to every other investment. This focusing helps to achieve the critical mass of investment that is needed for a renewal process to become self-sustaining and permanent, avoids the diffusion of resources that reduces their collective effectiveness, and lowers transaction and delivery costs. No unfocused source of money or talent can effectively substitute for either the psychological or financial value of large-scale local resources.

The ability to attract federally insured deposits and convert them into loans increases the amount of available development resources. These resources exist independent of any political appropriation or institutional allocation process. In addition, the marginal earnings on deposit accounts helps to subsidize the cost of development activities.

Accomplishments

During its fourteen years of operation the INDC has invested $147 million, $92 million of which has been in the form of loans made by the South Shore Bank. The remaining $55 million is composed of funds acquired by the non-bank subsidiaries. In addition, in the last several years, outsiders have begun to invest in South Shore. It is the magnitude of the investment, concentrated in a single area, that has brought about the turnaround.

The INDC's programs have resulted in the unsubsidized rehabilitation, at market rates and on market terms, of 5,600 rental housing units, and the subsidized rehabilitation of 1,300 units. A major shopping center is under construction.

Except in its first year the Bank operated profitably under INDC ownership, and in the last several years it has operated as profitably as other banks. Its level of earnings ($1.4 million after-tax for 1987) as a percentage of assets is average among Chicago's approximately 350 banks. Loan losses for three of the last four years have been lower than the industrial average for banks of its size. South Shore Bank is now three times larger than it was when INDC took it over: it has grown from a $42 million bank to a bank with total resources of $144 million.

The South Shore Bank uses the FDIC insurance tool to raise deposits from people throughout the United States who want to support its development program. They are paid competitive interest rates and are provided with whatever form of liquidity they prefer. The Bank today holds approximately $55 million of such funds which it has converted into development credit.

The South Shore community is stable. Its residents and business operators enjoy a high level of self-confidence. For the last six years there have been no new major tax delinquencies.

Lessons from INDC's Redevelopment Projects

Successful neighborhood redevelopment requires creating a psychology of renewal. Local residents will invest time and money to improve their neighborhoods when they are confident about the future. People at all income levels care about their communities -- about schools, crime, and quality shopping. But caring cannot be converted to investment unless a respected institution confirms and supports the hope for improvement. Because regulated depositories are knowledgeable, private economic institutions they may be best qualified to ignite community self-confidence.

Middle income residents best utilize development bank credit resources. Housing rehabilitation, job placement, remedial education and other socio-economic programs run by non-bank affiliates or community-based organizations better meet the needs of lower income residents. Small loans are generally unprofitable for banks, who are better able to finance people who have some accumulated savings and alternative sources of income to cushion the pressure of loan repayment schedules. The South Shore Bank services lower income residents indirectly by financing the housing rehabilitation and directly by making college education loans. INDC's non-bank affiliates improve the quality of rental housing and offer job skills training and employment services to lower income people. The unmet challenge in extending development credit is to lower the cost of delivery and to create a record of loan repayment by lower income residents so that they can more readily obtain the loans they need to achieve economic independence.

Eighteen years of experience has shown that neighborhood resident usually repay their development loans as scheduled, and that bank losses are not appreciably greater than they are from more conventional credits. The use of third-party guarantees, combined with a strictly professional approach, helps insure repayment.

It is difficult, but not impossible, to reconcile profit and development objectives. Although it is unusually challenging, neighborhood development banking can be profitable. But because they make smaller-than-normal loans, which often require higher-than-normal staff and security expenditures, a neighborhood development bank's operating cost is higher than that of an ordinary community bank. Higher costs can be partially offset by higher service fees, earnings on development deposits from outside the community, and superior management.

Successful development banking requires highly intelligent staff with rare technical skills. In addition to being competent bankers in every ordinary sense, neighborhood development bankers must be uncommonly sympathetic to the aspirations of loan applicants. They must encourage the borrower without ever losing sight of their primary responsibility to husband the institution's resources. People interested in development work are motivated primarily by the rigorous discipline and personal satisfaction that it embodies. They are resourceful, energetic, intelligent, and enthusiastic. But those qualities are only prerequisites to the technical competency that the job demands. Competency can be taught to intelligent and motivated people, but 18 to 24 months of training is required to produce an effective development credit officer, which significantly increases the time and cost of institutional growth. Experienced bankers who already possess the needed ability and skills are usually not motivated to apply their skills at a neighborhood level.

As mentioned, bank deposits attracted from outside the community can help offset a development bank's costs. They are a reliable, politically insulated, and potentially unlimited source of money that can be converted into development credit. Almost two decades ago the managers of INDC pioneered the use of development deposits solicited from outside the local community to supplement the locally available deposits. Since that time the idea has taken root. Various state governments have installed "linked deposit" programs under which public money is deposited with socially-responsive institutions. Money market and mutual funds now actively compete not only to deliver high yields and safety, but to assure investors that their funds are not being used for any socially destructive purpose. The social investment momentum is likely to accelerate as more people seek to exercise some control over the way their deposits are used.

Conclusion

Several components are prerequisite to a permanently renewing economy. A community-based, privately capitalized institution, run for profit and not as a charity, should be at the center of a broad and permanent development program. It must be clear that the renewal is not hostage to government whim or political change. The institution must control or have ready access to the essential resources of development: capital, credit, and talent. It must also possess the capacity to initiate action and maintain working relationships with local government. The managerial presence should be local. The renewal area should be geographically defined. Concurrent economic and social developments should be encouraged. Risk capital invested in the renewal process needs to be well leveraged, not only within the leading institution but also in each of the individual transactions. Finally, mechanisms must be crafted to assure the wholesale release of local energies in pursuit of neighborhood redevelopment. Community self-confidence must be reestablished and reinvestment induced from within every sector of the local economy. A deluge of bottom-up small-scale investment, combined with well-executed, large-scale projects appears to create the momentum needed for permanent renewal.

Mr. Grzywinski is the President of the South Shore Bank, in Chicago.

PART VI.

JOB CREATION IN THE SERVICE SECTOR

Chapter 23

Introduction to Part VI: An Entrepreneurial Approach to the Social Sector

American practitioners assert that they have learned a great deal from European programs for the unemployed which involved the service sector. The inquiry into the relationship between job creation and the new services is of common interest to policymakers and practitioners on both sides of the Atlantic.

The Enlarging Service Sector

Craig Kennedy, in Chapter 24, emphasizes the increasing demand for services to meet new needs. A variety of factors contributes to this new demand. First, the ageing of the population calls for new forms of housing, transport, and special services for the elderly, such as home care. Second, the increasing number of working women increases the demand for such services as child care, convenience restaurants and convenience foods. Third, the change in household composition, with more and more people living alone, requires the adaptation of housing and services. And finally, the increase in free time creates a demand for new leisure activities.

The enlargement of the service sector is due not only to the increasing demand for services, but also to the withdrawal of government from the provision of them. Even though public agencies may still fund the services in question, their role in delivery of services is diminishing. This is partly due to the reduction of public expenditure and partly due to the growing awareness that the public sector, with its compartmentalized and bureaucratic management methods, might no longer be the best provider of services to meet the new demands. The resident managers of Kenilworth Parkside, described by Kimi Gray in Chapter 25, and the worker-owners of Cooperative Home Care Associates, discussed by Rick Surpin in Chapter 26, are examples of private providers of services that were previously the responsibility of public agencies.

The Service Sector and Urban Renewal

American experience has demonstrated that there is a relationship between urban redevelopment, particularly housing rehabilitation, and the service sector. That experience could be applied in France, for example by further developing the already existing district corporations.

In public housing especially, basic services such as the maintenance of common facilities, cleaning, and small repairs are often poorly provided for, either because landlords find it hard to pay for them or because responsibilities overlap and the decisionmaking center is far away. The district corporations can improve the service given, involve the inhabitants in managing their own environment, and effect social integration, particularly for young people.

An Entrepreneurial Approach

American experience has shown that communities can be revitalized by an entrepreneurial approach to their problems, and by an entrepreneurial approach to the service sector. That approach is significant in several respects.

First, where work entry is linked with the development of services, the autonomy-creating economic approach takes precedence over an assistance approach. It is a fundamental point: if social transfers and various forms of public credit are used, it is with a view ultimately to dropping such funding and doing without them. American experience has inspired discussion in France about ways of managing and deploying national or local programs like the **revenus minimum d'insertion** (minimum income linked with work entry). Such very expensive programs make sense only if they are accompanied by incentives to use the funds for the creation of new permanent employment for the recipient groups. Similarly, American experience might persuade local authorities to review their methods of managing their enormous welfare budgets, which are still too often managed like welfare programs.

Second, the entrepreneurial approach involves a special form of cost and quality management. Analyzing the environment, evaluating results, heeding the "customer" receiving the service, and taking a marketing approach are still not sufficiently widespread methods in France in the service sector. Cooperative Home Care Associates in New York, discussed by Rick Surpin in Chapter 26, combines the social goals of a non-profit organization with the profit-making methods of a private company. The author stresses that the spirit of enterprise is a key factor for efficient business operation.

Third, a new type of entrepreneur has emerged as a result of the entrepreneurial approach to the service sector. This is no small achievement, for the new type of entrepreneur must combine leadership, managerial efficiency, and sensitivity to a demand which is primarily social. The current delay in developing the service sector, for which the need does exist, is due more to the shortage of project designers than to financing problems. Encouraging, training, and supporting this new type of entrepreneur, and developing systems of the service-franchise type, have become matters of crucial importance.

The Importance of Foundations

An additional lesson to be drawn from the United States is the importance of the role played by foundations in developing the service sector. The Ford Foundation, the Rockefeller Foundation, the Joyce Foundation, the German Marshall Fund, and many more, do not appear to have any real equivalent in France, apart from the Fondation de France. Foundations can mobilize private finance and skills, a function whose absence is still acutely felt in most European countries, where the private, non-profit, and public sectors have little to do with one another. Various forms of partnership are possible, such as agreements between private business and work entry ventures providing for forms of collaboration like the temporary provision of executive staff, access to training, donation of equipment, and management support.

The United States has much more to teach along these lines than about the traditional "odd job" approach, whose limits must be increasingly recognized. In Chapter 27, Cicero Wilson cautions that the success of the American job machine for the long-term unemployed must be kept in proper perspective. In spite of its job creation record, the United States still excludes many people from the labor market, a tragic factor which must be remembered in evaluating the American experience.

Hugues Sibille

Chapter 24

Economic Development and the New Service Sector

Craig Kennedy

The new service sector is an important economic development for all entrepreneurs, but most particularly for low-income entrepreneurs. While the economically disadvantaged have established businesses in other markets and other sectors of the economy, low-income entrepreneurship has focused strongly on business opportunities in a sector that has long been dominated in the United States and elsewhere by public providers.

What is the New Service Sector?

For some, the new service sector includes those services that have traditionally been provided by families, voluntary networks, or government, such as day care, health care, supplementary education, and other personal human services. Others would add to that list any service or item that has not traditionally been provided by profit-making enterprises, such as fire protection, security and anti-crime services, housing for low-income and special-need populations, and other public goods and services. But the central feature of the new services is not that they are "new" in the way that technology-related businesses are. What is new is that their economic potential is being exploited.

Why the New Service Sector Has Developed

Four factors account for the development of the new service sector in the United States. First, there has been increasing demand for such services by people who are willing to pay for them. The entry into the workforce of large numbers of women has created a need for day care that cannot be met by traditional public, non-profit, or family sources. The growing number of older people requiring health care, combined with changes in public health care financing, has increased the necessity for home health care services. A fear of crime in affluent urban neighborhoods has created a requirement for security services. Social and demographic changes have been the dominant factor in creating private markets for services in areas where, in the past, demand was weak or non-existent.

Second, new niches for private enterprise have developed as government agencies have "privatized" the provision of key services. While public finance may still subsidize services such as health care, day care, housing, and education, public agencies are less likely to be the providers.

Third, public providers have failed to deliver good quality services. In the area of primary and secondary education particularly, long an almost exclusively public sector enterprise, many parents' dissatisfaction with the quality of public schools has driven them to choose private, non-profit alternatives. Others have kept their children in public schools but have sought supplementary educational services from for-profit and non-profit providers. In Chicago and many other cities, advertisements in local newspapers for tutoring, reading centers, and other supplementary services are common.

Finally, the financial problems of governments in the United States, and a correspondingly strong concern about the cost of providing services, has led to an increased private interest in their provision. The demand for home health care, for example, reflects in part governments' interest in keeping physically and mentally impaired people out of hospitals and nursing homes because institutional care is too expensive.

Low-Income Entrepreneurs

Interest in low-income entrepreneurs has paralleled and, in some cases, coincided with the growing demand for the new private services. As with many innovations and experiments, the impetus for this movement stemmed from the failures of the past, when three principal strategies were used to attempt to integrate low-income people into the economic mainstream. To different degrees and in different ways, all three failed.

The first strategy, job training programs, a main component of U.S. social policy in the 1960s and 1970s, frequently trained people for jobs that did not exist or were disappearing. Although some programs achieved a degree of success, their inefficiencies and poor linkages with business have discouraged experts and public officials from using them as a mainstay of social policy. Minority small business development schemes share a similar record. Some training and financing efforts have been successful, but the majority of them have failed as engines for job creation in low-income areas.

The third traditional approach has been the use of Community Development Corporations (CDCs), non-profit enterprises that seek to upgrade economically depressed communities. In the 1960s and 1970s, the Ford Foundation and other public and private donors financed hundreds of CDCs. Many of them successfully attacked housing problems, others developed considerable expertise in supporting local retail development, but very few have ever significantly stimulated the creation of large numbers of jobs for low-income people.

Dissatisfaction with existing strategies impelled the search for alternatives. One of these was the idea of low-income entrepreneurship. In the beginning, however, the idea was not met enthusiastically. Public officials and foundation executives did not believe that unskilled, often uneducated welfare recipients could start viable businesses. To them, low-income entrepreneurship was a proposition born of desperation, not creativity. But as people became aware of certain French and British programs for the unemployed, and some venturesome practitioners in the United States began modest tests, the notion that low-income people could create businesses and enhance their economic position began to gain acceptance.

Low-income entrepreneurship will not solve all the problems of distressed communities. Nor is it appropriate for large numbers of people. But some low-income people can move from dependency to self-sufficiency by starting businesses and, in so doing, create jobs for others in their communities. Equally important, low-income entrepreneurs help to break down stereotypes about the capabilities of poor people and the economic viability of their communities.

The Link Between the New Services and Low-Income Entrepreneurs

Low-income entrepreneurs tend to develop their businesses in the new service sector. This is due in part to the rapid growth of that sector, but there are other reasons for the link.

First, the new service sector tends to have low entry barriers. Many of its business opportunities can be exploited without a large investment of capital and without substantial technical expertise. Home care for the elderly, day care for the handicapped, and personal services for the housebound may require great skill and responsibility, but they do not require high levels of formal education.

An additional reason for the link between low-income entrepreneurship and the new service sector is the search for ways to make public expenditures do double duty. It has been discovered in the United States and elsewhere that unemployment benefits designed to support families can also be used to stimulate job creation. Low-income entrepreneurs can provide a variety of public services. For example, the Chicago public housing authority is considering using small firms owned by low-income residents to carry out maintenance and repair work. Several states have set up programs to train low-income women in establishing day care centers which will be publicly supported. The political popularity of recycling government expenditures by using public money to encourage business development in poor neighborhoods will undoubtedly heighten efforts to stimulate low-income entrepreneurship.

The Role of Foundations

American foundations are often characterized as great sources of "social venture capital". Although these private institutions provide only $4.5 billion a year to non-profit activities, they have developed a reputation for being the financial engines that drive social innovation in the United States. The Ford Foundation, the Rockefeller Foundation, and many others, have helped to finance and develop key programs and ideas that are now largely funded by government. For example, Head Start, the early childhood education program for poor children, was initially supported by the Ford Foundation.

But, as is the case with many institutions that claim to be innovative, foundations have sometimes ignored important ideas or have supported them only after they had achieved wide acceptance. Such was the case with the new service sector. Some foundation aid was given, but for the most part the sector developed without philanthropic support.

By contrast, almost from the beginning, foundations have supported research, education, and model testing in the area of low-income entrepreneurship. The German Marshall Fund (GMF) has been the key donor, not because of the size of its grants but because of the timing and nature of its support. At a time when Americans were groping for new job-creation strategies for low-income communities, the GMF began to sponsor study tours that brought U.S. practitioners into contact with model entrepreneurial training programs in Europe.

After the initial exploratory phase, other foundations, mainly in the Midwest, began supporting low-income entrepreneurship programs. The Midwestern states, those in the industrial heartland of the United States, have been undergoing serious economic restructuring since the early 1970s. Steel, automobile manufacturing, and other heavy industries have faded, only partially to be replaced by service and technology related businesses.

The Midwest's economic restructuring has been especially hard on low-income people. The well-paid, blue collar jobs associated with traditional heavy industries were one of the major avenues to economic self-sufficiency. According to William Julius Wilson, a prominent sociologist at the University of Chicago, the re-emergence of poverty as an important urban problem is directly tied to the loss of those generally low-skilled but well-paid jobs. Without that ladder out of poverty, the underclass can only expand.

For Midwestern foundations, notably Mott in Michigan and Gund in Cleveland, the economic upheaval served to highlight the limitations of standard strategies for dealing with the lack of jobs in poor communities. While a number of donors have supported experiments in low-income business development, Midwestern foundations have been especially supportive.

How Foundations Approach the Problem

Generally, foundations have sought to support activities designed to test and refine the idea of low-income entrepreneurship so that government entities will take the plan seriously and offer to help with public funds. To that end, foundations provide four types of grants.

First, the Joyce Foundation, among others, primarily supports model projects to train and finance low-income entrepreneurs. This may include helping an organization develop the expertise to run programs, funding training and technical assistance for new businesses, or capitalizing modest loan funds for new enterprises when traditional bank financing is unavailable. The Joyce Foundation has sought out programs serving different types of populations such as low-income minority women, rural populations, and middle-aged, unemployed industrial workers.

Second, foundations fund assessments of the effectiveness of low-income entrepreneurship programs as vehicles for job creation and business development. They seek to build up the body of evidence that will convince private financial institutions and public agencies to adopt the programs and provide the long-term funding that financially constrained foundations cannot supply.

Third, Joyce and other foundations support advocacy programs -- publicizing efforts -- aimed at convincing public officials and private enterprise that low-income entrepreneurship programs deserve their attention.

Finally, foundations support thinkers and educators, individuals and organizations that are exploring entrepreneurship in general and low-income entrepreneurship in particular. It is this group that most directly uses the evidence of low-income entrepreneurship programs to disassemble the stereotypes that many Americans -- government officials, business leaders, non-profit administrators, and the general public alike -- have of the economic potential of poor people and their communities.

The Importance of Political Independence

That foundations are independent of government is extremely important. While there are some government bureaucrats who are innovative, there are too few of them to make an experimental dynamo. Most bureaucrats are risk averse and refuse to test new ideas that they consider too controversial or too difficult. Foundations can take risks. They are not required to monitor the political winds, and they can safely lose money in the pursuit of testing new ideas. Equally important, they can respond more quickly than public agencies to requests for support in launching a new idea.

Like other foundations that invest in new and unusual ideas, the Joyce Foundation is investing in low-income entrepreneurship programs as an experiment. If the model programs yield disappointing results, or if other larger, more powerful institutions fail to support their growth, that investment may have to be questioned. But foundations can be patient investors, and the Joyce Foundation is confident that, in the case of low-income entrepreneurship programs, its patience will be rewarded.

Mr. Kennedy is the President of the Joyce Foundation in Chicago.

Note: The German Marshall Fund of the United States

The German Marshall Fund of the United States (GMF) was established in 1972 by a gift from the Federal Republic of Germany as a memorial to the Marshall Plan. Since 1972, the Fund has received more than $57 million. The GMF is an independent American organization, as stipulated by the German gift.

The GMF supports and implements activities that promote an informed understanding of issues arising between Western Europe and the United States, and that educate policymakers about how their counterparts on the other side of the Atlantic deal with domestic problems common to industrial societies.

The Comparative Domestic Program

The Comparative Domestic Program is one of the many programs administered by the GMF. It concentrates on several substantive areas in which there are innovative social, economic, or institutional policies on one side of the Atlantic, and interest and institutional receptivity on the other.

The GMF's Employment Program, one part of the Comparative Domestic Program, addresses employment and labor market policies and practices. Its focus is on the program level, where the GMF has access to political and business leaders, program administrators, trade unionists, and educators -- people who can take constructive action. The Employment Program seeks to assist U.S. and European practitioners and policymakers with projects addressing job creation, community economic development, changes due to new technologies, the employment of women, youth, displaced workers and the long-term unemployed, and innovative forms of public/private partnerships.

The GMF's Policies

Principally, the GMF makes grants to other organizations; it also conducts its own fellowship and short-term travel programs.

Three policies govern the grants made by the GMF. First, all projects must address issues important to both Western Europe and the United States, and must involve people or institutions from both. Second, preference is given to projects focused on the transfer of experience. Third, a plan for the dissemination of observations or a plan for implementation of new approaches must be included in the project.

From information provided by Anne Heald, Program Director, The German Marshall Fund.

Chapter 25

Kenilworth Parkside's Resident Managers

Kimi O. Gray

The History of Kenilworth Parkside

Kenilworth Parkside's 464 housing units were built in 1959 in the forgotten part of Washington, D.C., the "other side of the river". Its 3 000 residents, 85 per cent of whom were supported by public assistance, received the fewest services from the city government. For three years Kenilworth Parkside had no heat and no hot water. There was no rubbish disposal service, and rats infested the buildings. Residents refused to pay rent because of the lack of services. Kenilworth Parkside is owned by the federal government, and during the period in which it deteriorated it was run by an agency of the local government which sub-contracted the management of the complex to a for-profit management firm.

In 1980, the residents of Kenilworth Parkside undertook a city-wide voter registration drive in which 12 500 residents were registered. The residents' intention was to elect a mayor who was concerned about poor people, and they elected Marion Barry. They told the mayor that they wanted to manage their own public housing, which prior to that time had never been done. The residents were thought of as too uneducated, illiterate, and lazy.

Before being allowed to take over the management of their property, the residents were required by the local government to fulfill specified conditions, which included one year of training in public housing management. After that, they registered with the Office of the Recorder of Deeds as the Kenilworth Parkside Resident Management Corporation, Non-Profit (KPRMC).

In the meantime, the private management firm had heard of the residents' actions and it abandoned the property in December 1981. The winter of 1981-82 was the coldest in the United States since 1949. There was still no heat or hot water in the complex, pipes were splitting, and people were being flooded out of their homes. But now, instead of being able to call downtown for help, the residents had to turn to themselves.

Their first step was to create a method of communication through elected building and court captains, each of whom represented from 12 to 14 families. Next, the KPRMC hired staff from among the residents: a manager, an assistant manager, an accounting clerk, a secretary, a clerk-typist, and some administrators. The KPRMC decided not to accept the federal subsidy that generally augments a public housing property's operating budget. As a result, the staff began with very low salaries which have gradually increased.

Knowing that their unemployed fathers and sons had skills, that they were not merely alchoholics and drug-dealers, the KPRMC hired one of its resident men as maintenance foreman, and others as boiler engineers, plasterers, plumbers, carpenters, and electricians. The helpers were their sons. The staff has since been expanded to include 13 groundskeepers, 12 day-care workers in two day-care centers, and three social service workers who help residents obtain the services to which they are entitled.

Emphasis on Residents' Needs

Before 1975, only two of Kenilworth Parkside's youngsters had ever attended college. In 1975, through a parent booster club, the residents helped students with applications for college admission and for the federal financial aid to which most of them are entitled. The booster club raised funds and sent 17 students to college. To date, 582 students have been attending college on the condition that they return to the community to do at least a one or two-year internship to upgrade the community and to help other students.

Using its college students, the KPRMC carried out a "needs" survey to determine the priorities of its residents. An employment office was established as well as a health center. The KPRMC contracted with private doctors and established practices for them in the community, on the condition that they would undertake home visits and give special attention to babies and senior citizens.

The residents' association set up a day-care center for children of two to five years old. Because that center did not sufficiently meet the community's needs, and in order to create jobs for women in their forties who had been teenage mothers and whose only skills were raising children, the KPRMC subsequently opened ten day-care homes and another "learning center". A curriculum in early child education was developed, and the women obtained certificates to be day-care home providers. The residents then created a latchkey program in which children of working parents are given tutoring in math, reading, and science from 3:30 p.m. until 7:30 p.m., and a hot meal in the evenings.

The KPRMC created a college preparatory program, a youth training program in home repair, a youth/adult education program for GED preparatory classes where students obtain training in any field they choose, and a youth entrepreneurship program to train students for a career in business.

Entrepreneurship

Once again using their college students' talents, the KPRMC undertook a simple economic study to determine the community's market potential. The study showed that the average monthly family income was $1,000, from transfer payments and private employment. Even subtracting the 30 per cent of income that low-income families in the United States must spend for rent, and even if 60 per cent of the remaining disposable income were spent elsewhere, Kenilworth Parkside residents had $1.5 million per year that could be recaptured for the community. The residents decided to develop the community's economic potential by no longer being mere consumers but by becoming producers and dealing with each other.

Every public housing property in the United States has a resident council. When it assumed management control, the KPRMC did not abolish its resident council but instead turned it into a holding company offering small loans at very low interest rates to create businesses. The KPRMC started its business development activities by sponsoring a small shop for a young resident who could neither read nor count but who had a particular talent for making replacement windows, awnings, and doors. He is now the owner and co-manager of his own shop. His only obligation was to train ten students in his skills, and those ten students now market their services throughout the Washington area.

Because the neighborhood had always received only the very poorest quality produce and meats, the residents established a co-op market which they stock with groceries themselves. They also opened a snack bar in their recreation centre as an alternative to the fast-food restaurant across the highway.

Two welfare recipients with sewing skills opened a boutique where they sell clothing made on the premises. Students are sent to school to learn cosmetology and barbering, and a beauty salon and barbershop now operate in the community. The KPRMC has opened two very profitable laundromats. The mother of one of the worst behaved children in the complex was chosen to manage them, and as a result they have not been subjected to vandalism.

The KPRMC dismissed the rubbish collection service and appointed a young man in its place whose only obligation was to hire Kenilworth Parkside residents to work in his business. There is no longer trash on the streets.

A company was set up for young people who rehabilitate vacant apartment units in the complex. In addition, the KPRMC has created a thrift shop, a catering service, and roofing, moving, and construction companies. All the small businesses are managed by, and employ residents of, Kenilworth Parkside, all the services employ residents, and all contractors are elected by the board of the KPRMC. All businesses must hire young people to work with adults.

Accomplishments

KPRMC has more than quadrupled its rent collection, and the residents' dependence on public assistance has been reduced by 50 per cent. Operating and utility costs have been reduced, as has vandalism. Crime has been reduced by 99 per cent, teenage pregnancy by 50 per cent.

The original KPRMC staff of 32 has increased to 170, all of whom have a benefit package that includes health insurance, retirement benefits, sick and vacation leave, and wage bonuses for exceptional performance.

The KPRMC's next goals are to build a senior citizens' building and to manage a 25-unit apartment complex to house its college students and keep them in the community. The KPRMC wishes to erase the myths about public housing and to demonstrate that residents can set standards, economically and socially, that they are able to handle the responsibility for maintaining their community, and that poor people can take care of themselves if they are given the opportunity to do so. Resident management is not the only answer to the problems of managing public housing, but it is an alternative that works.

Ms. Gray is the President of the Kenilworth Parkside Resident's Association, in Washington, D.C.

Chapter 26

Home Health Care in New York

Rick Surpin

The Home Health Care Industry

Home health care consists of a wide range of services, including nursing, physical therapy, and paraprofessional services. Paraprofessionals, known as home health aides, attend to the hygiene, shopping, cooking, and laundry needs of elderly and disabled patients in their own homes. There are over 10 000 home care paraprofessionals working in New York City today, and they represent over two-thirds of the industry's costs. Virtually all of them are women, and most are black or hispanic.

Home care paraprofessionals are among the working poor, generally earning little more than the minimum wage. In New York City, the typical wage is about $4 an hour. Many workers are unable to obtain full-time, year-round employment and generally make less than $10 000 per year. Ironically, they do not have adequate health insurance to meet their own needs. They receive no rewards for good performance, experience, or for acquiring increased skills. The result is an industry plagued with high staff turnover, a shortage of people willing to work under prevailing conditions, and inconsistent service to clients.

Due to changes in public health care policy which recognize that it is more humane and less costly than long-term care in hospitals or nursing homes, the home health care industry is growing rapidly, both in New York and in the nation. Its growth is fuelled by public sector financing in the form of Medicaid and Medicare, but the agencies which provide the care are typically under either non-profit or proprietary sponsorship rather than direct public control.[1]

Cooperative Home Care Associates

Cooperative Home Care Associates (CHCA) was started in 1985 under the sponsorship of the Community Service Society as a worker-owned home health care company in the South Bronx section of New York City. CHCA had two goals: to create paraprofessional jobs with better wages, fringe benefits, working conditions, stability, and opportunity for upward mobility than currently exists in the industry, and to provide high quality home care services for elderly and disabled patients.

Since 1985, when CHCA began with one initial contract with a home health agency and twelve home health aides, it has expanded to five additional contracts, 170 workers, and annual sales of over $1.5 million. The company expects to grow to 300 workers by the end of 1989. Like other home health care companies, CHCA has grown because of prevailing market conditions. But for its workers, CHCA is very different from other companies in the industry.

Wages and Benefits

As a worker-owned company, it is CHCA's business policy to create the best possible jobs in the home care industry. Although the average starting wage in the industry is between $4.00-$4.25 an hour with several companies paying $4.50, CHCA pays $4.75 an hour with standardized, yearly increases. In an industry that averages 60-70 per cent part-time employment, only 30 per cent of CHCA's employees are part-time. Workers are provided with life insurance, a uniform allowance, and five paid vacation days per year. A health insurance scheme is being formulated. When the company became profitable, in 1987, its first fifteen worker-owners each received an average of $300 under the company's profit sharing scheme.

CHCA has invested significantly in staff development through a program which combines entry-level training and worker ownership education. Worker-owners learn about the company's business plan and how to read a financial statement. So that they can address company problems as they arise, they learn how the company's policies support the values and goals inherent in the worker ownership structure.

Training is primarily conducted through small group exercises rather than through lectures. Teams are established for educational sessions and to enable people to meet and get to know one another. In conjunction with a major educational institution, the company has also started to plan a career upgrading program, for training toward a nursing degree.

CHCA treats its workforce as people in whom it wishes to invest, rather than as replaceable parts. As a result, while the home health industry in general has difficulty recruiting workers, CHCA often has a waiting list of up to 150 people and can be highly selective in its recruitment of staff.

Financing the Company

Because CHCA's worker-owners are poor people without the means to make sufficient equity investments in the company, and because the company is virtually without fixed assets, traditional sources of financing have been unavailable to it. The initial funding package for the company consisted of three elements: the Community Service Society and United Hospital each contributed $50 000 for start-up and development costs, various foundations acted as alternative loan sources for working capital, and receivables were financed by non-traditional sources as well. These three sources contributed to a capital base of $900 000.

In addition, CHCA received grants for its worker education and training activities from the New York Private Industry Council, the State Department of Labor, and the Regional Center for Economic Development, in collaboration with La Guardia Community College. Foundation support for the company was crucial. Without it, CHCA would never have been viable.

Ownership and Management

The cooperative form of ownership used by CHCA was modeled on that of the Caja Laboral in the Basque region of Spain. It was unlike any approach that had previously been made in attempting to form worker cooperatives in New York City. Its essential feature is the absence of outside owners.

Only people who work in the company can be owners. Workers are eligible to become owners after passing a three-month performance probation period and making a $50 payment toward a total membership fee of $1 000, the remainder of which is collected through payroll deductions over five years. Six of the nine seats on the board of directors are held by worker-owners, and three are held by representatives of the Community Service Society. Worker-owners have the right to vote and to participate in the running of the company.

Responsibility for the day-to-day management of the cooperative rests with a general manager who is supported by a small administrative staff. All employees attend regular team meetings. In addition to being the principal means of internal communication, the meetings provide in-service education and serve to organize social events.

Results

The current trend in the United States is for outside owners of the wealth created by low profit-margin companies to spend that wealth on consumer goods and luxuries for themselves, not to use it to improve the wages and benefits of their companies' workers. The home health care service has been a low-margin, labor-intensive industry relying on high volume, low wages, and part-time work to make it profitable. CHCA has sought to go against the grain of the existing home health care industry while establishing itself as a high quality service agency and a viable business. It has challenged the traditional approach and has outperformed its competitors on all indicators. It has reached an efficient scale of operation and is now the largest known low-income worker cooperative in the United States.

CHCA has consistently received excellent evaluations of its services from its contractors. The company's profits are consistent with the industry average, and it has good prospects for continued growth. CHCA's employee turnover rate is 30 per cent, compared to a 60 per cent industry average. As mentioned above, its wages are higher and its benefits better than those prevailing in the industry, and 70 per cent of its workforce are full-time, permanent employees.

Low reimbursement rates from Medicare and Medicaid, the public financing mechanisms which pay for virtually all of the nation's home care services, make it impossible to compensate home care paraprofessionals with adequate salaries and fringe benefits. But CHCA's worker-ownership structure, with no outside owners, has enabled CHCA to stretch these financial limits and provide a better job than the rest of the industry.

Plans for the Future

CHCA's progress has not come easily and there remains much more work to do before it will have accomplished its goals. CHCA was founded with the vision that paraprofessionals in home health care should have permanent, salaried positions, adequate pay and fringe benefits, opportunity for career advancement, and a sense of belonging to an organization which cares about and supports their daily work.

CHCA will continue to strive to be a viable business and to provide the highest wages and benefits in the industry. If possible, CHCA will develop related services which will expand its educational and career upgrading opportunities for its worker-members and staff. Both the jobs and profits generated by the business will remain in the local area since the workers, who own and control the enterprise, are also community residents.

For its first three years CHCA was, for all practical purposes, controlled by the non-profit organization which started it, Community Service Society. Recently, the company has entered a new phase where the Society's control has lessened and the workers are controlling the company. CHCA will continue to foster an active and democratic membership organization and to develop leaders who know how to manage a profitable business, and how to represent the long-term interests of the group.

To an extent, CHCA's ability to realize its goals is dependent on policies and practices beyond its influence or control. First, efficient staff utilization and the ability to provide stable, full-time employment is largely dictated by hospital discharge planning staff. Hospital-based health professionals generally accord low status to the home health care industry and maintain only patchy allegiance to it. Second, it may be difficult, if not impossible, for CHCA to provide further wage increases and fringe benefits to its workers if the level of reimbursement from Medicare and Medicaid is not improved. In order to be able to influence the external factors that inhibit the company's progress, CHCA intends to deploy a group of worker-owners to advocate public policies and reimbursement rates that will further its objectives.

Current public policy assumes that the home health industry is an extension of "women's work" in the home and, therefore, that its workers require little training, minimal compensation, and no opportunity for advancement. The industry today is one in which the public sector intervenes to promote the creation of dead-end jobs at below poverty-level wages, primarily for poor women. Because the quality of care depends a great deal on continuity, consistency, and skill development, quality job creation and quality health care are directly linked.

CHCA provides an alternative model to the current state of the home health care industry, and it has demonstrated that it is possible to establish a viable business while addressing both workers' and patients' needs.

It remains to be seen whether CHCA will remain simply an alternative model or whether it will become a pacesetter in an industry striving to establish new standards for both quality of work life for home health care paraprofessionals and for services delivered. In any event, CHCA provides a practical testing ground for discovering the possibilities and limitations of efforts to improve job quality for low and medium-skilled workers. CHCA provides a unique source of data and ideas for public policymakers who are concerned about creating a more efficient and equitable labor market.

Mr. Surpin is the Director of the Cooperative Home Care Development Program of the Community Service Society, in New York.

Chapter 27

The Long-Term Unemployed

Cicero Wilson

The "Great American Job Machine" does not address the urban underclass, it has done very little for the long-term unemployed, and it is barely keeping afloat the 9 million working poor -- those who work full-time, year-round for the minimum wage.

Local partnerships often start in a small way, undertaking projects that can be initially successful, and as a consequence their efforts have avoided dealing with more difficult populations, including the long-term unemployed. Eventually, the Job Machine may help them, but in the short term it is very difficult keeping them housed and fed.

In discussing local job creation and the business climate in distressed communities, there is a preliminary point that must be emphasized: there is no greater impediment to job creation, or even to participating in education and training schemes, than crime in the streets. An evening training program for the working poor cannot even be considered if people are afraid to leave their homes after dark.

Pressure on Public Agencies

What success there has been with regard to the long-term unemployed is largely due to the support given to and pressure put on public agencies by corporations and foundations. Those organizations provide funds for experimental programs which the government would never implement if they had not been initially funded and tested by the private sector. It is primarily the foundations who fuel programmatic experiments.

A further key to success in treating the problem of the long-term unemployed is the willingness of public agencies to experiment with public/private partnerships, and with approaches that are counter-intuitive in American mainline thinking. This usually comes about when the public agencies have very little choice but to experiment, for example, when they are faced with rising welfare costs and a coal mine or major plant closing down.

The Service Economy

The frequently expressed concern about the low quality of many of the service jobs being created is valid in reference to mature workers who are heads of households. But for young, non-white youth, (for whom the unemployment rate is 50 per cent or higher), the part-time, minimum-wage jobs are not plentiful enough. For such workers, the alternative to those jobs is street crime. There are far too many young males between 20 and 30 years old who have never worked, and whose only source of income is on the street selling drugs.

For mature workers, the problem with the low-wage service jobs is evident from the homeless statistics: one in five homeless adults works either full or part-time. One would think that a working person would at least be able to afford somewhere to live.

Furthermore, service employment does not have to be low paid. Much of it is not. Jobs in financial, business, real-estate, and legal services are often very well paid. Jobs in consumer services, such as hotels, laundries, beauty parlors, car repair shops, and home health care tend to be part-time and low paid, but the businesses themselves are not necessarily low profit businesses. Their owners often choose to increase their profits by paying low wages and hiring part-time employees to avoid paying the cost of health care benefits. Consequently, cooperative forms of ownership are beginning to be created as a means of controlling the way profits are used.

Economies of scale do not necessarily force service jobs into being part-time, low-wage jobs. Many service businesses, such as Kinder-Care -- a pre-school and day care service -- operate as multi-unit franchises. Kinder-Care units in many locations gross more than $400 000 per year while paying decent wages and allowing flexible hours. It is important not to confuse limitations in the size of the potential market for a service enterprise with limitations on the size of the firms. Multi-unit firms like Kinder-Care and H & R Block, a tax return service, are quite large, even though their units serve very small local areas.

Approaches to Job Creation for the Long-Term Unemployed

The problems of the underclass, with the exception of drug trafficking and drug use, can be addressed by a sensitive social service response and an on-target job creation and employment response. These will rapidly take people out of their depression and make them eager to work. The most serious impediment to success in treating the problems of the underclass is underestimating their capacity and desire to rejoin the mainstream.

The success of any job creation program for the long-term unemployed depends on politicians and public agencies shedding entrenched and inaccurate stereotypes about poor people, and recognizing that although poor communities have less money than other groups, they do have money to spend and are viable markets to be served.

A low-income community of 400 households, where all the households are supported by public assistance and have annual incomes of $4 000, will spend

$500 000 per year on housing, over $500 000 on food and clothing, $400 000 on transportation and personal services, and $160 000 on laundry services. Unfortunately, those expenditures are usually collected by absentee owners of the businesses and are taken away from the neighborhood into the middle-class suburbs.

Programs aimed at job creation for communities with substantial numbers of long-term unemployed should be designed to keep the community's money in the community -- a re-cycling process best illustrated by an example:

A laundromat is a service business with a low start-up cost, generally under $200 000. The community entrepreneur or organization needs only $10 000 to $15 000 in equity in order to begin. The business can support two or three employees at wages 50 per cent higher than the minimum wage, can provide family health insurance, sick and vacation leave, and still make a 21 per cent profit, or $30 000 to $50 000 before taxes. This type of service business is susceptible to community or cooperative ownership and to a multi-unit franchise approach. And, most important, it re-cycles community money back into the community rather than transferring it to the suburbs to be spent on consumer goods for absentee middle-class owners.

The United States made a serious mistake in its policy on poverty in encouraging people moving up the income ladder to move out of their old community. That policy intensified the problems of the underclass. Kenilworth Parkside's success (discussed in Chapter 25) was largely due to providing the incentive of improving personal income while being able to stay in the old community and having it improve as well. The interaction between personal improvement and community improvement is particularly important for minority communities.

Importance of the Black Middle Class

Successful job creation programs for the long-term unemployed among the black population in the United States have recognized and taken advantage of the contribution to be made by the black middle class. Black people have entered the middle income category in considerable numbers over the past twenty years: the percentage of the population earning over $25 000 per year has risen from 15 per cent to 35 per cent, and those earning more than $50 000 a year has increased from 2 per cent to 8 per cent. (Figures are adjusted for inflation.) When the black middle class can be mobilized to help the underclass and the long-term unemployed, it becomes -- by virtue of education, income, and commitment -- a formidable private sector partner in generating job opportunities and social services.

The activities of a church in the black community in Baltimore illustrate the extent to which the black middle class can help improve conditions for the underclass. The black middle class members of the church provide free staff support valued at nearly $750 000 per year, with additional donations of cash and food valued at over $400 000 per year, to a church program that provides free social services to 2 000 people each month. The church program handles the emergency and overflow clients from the Baltimore welfare department. On the occasion of a special service held for the unemployed one Labor Day holiday, the pastor asked black professionals and business owners to attend the service and make at least one concrete offer of work for an unemployed member of the congregation. In that single day 300 jobs were created.

The Need to Change Community Attitudes

Creating jobs for the long-term unemployed and improving conditions for the underclass requires more than job training and encouraging better performance by the schools. It requires changing the community's own economic expectations by focusing on and addressing its economic and social attitudes. It means dealing with a community where many residents have had few, if any, contacts with people who have had the opportunity to obtain an education, to start a business, or to move up the income ladder without leaving their neighborhood. People in such circumstances may be limited in their vision of the advantages of staying in school or working at a job. It is only when a climate of higher economic expectations is created through a change in community attitudes, and when people who are succeeding can be encouraged to stay in the community, that partnerships and other linkages for economic development can begin to be established.

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PART VII.

EMPLOYMENT DEVELOPMENT IN TRADE AND DISTRIBUTION

Chapter 28

Introduction to Part VII:

Changes in Trade and Distribution

Of the 30 million net jobs created in the United States between 1969 and 1987, 9 million, or nearly one-third, are attributable to trade. Unlike France, the American definition of the retail trade includes hotels, restaurants, and motor vehicle sales. Using that definition, trade in the United States accounts for 23.3 per cent of total employment, 5.7 per cent of which is wholesale, and 17.6 per cent of which is retail.

In hotels and restaurants wages are low and are continuing to fall: they were 58 per cent of the trading sector average in 1970, and 52 per cent in 1984. Productivity is also declining, by -1.2 per cent over the last 15 years. This sector, which is economically important, (providing 5.4 per cent of total national employment), is growing particularly quickly.

In other commercial sectors earnings are mediocre, but productivity and growth are only slightly below the national average. According to the study by J. Dessaint and F. Ecalle, "the trend of demand in trade is broadly the same as that of final demand in the economy as a whole".(1) Working hours have fallen slightly more than in the rest of the economy (-0.7 per cent per year, as against -0.4 per cent), while hourly productivity has improved slightly more (by 1.5 per cent in the wholesale trade and by 1.6 per cent in the retail trade, apart from hotels and restaurants compared with 1.2 per cent in the trading sector and 2.8 per cent in industry). Certain individual industries have even made higher productivity gains than industry as a whole (drugstores: +4.1 per cent; service stations: +3.9 per cent). Productivity gains are due to economies of scale, the use of computerized management, a greater concentration of shops (there are 0.8 food shops per 1 000 inhabitants in the United States, 1 in the United Kingdom, 1.4 in Germany and 1.5 in France), and better customer services: price competition in the United States is increasingly joined by quality-of-service competition.

The Effect of Technology

According to John Naisbitt,(2) the first robot waiters should be making their début very shortly in the fast food chains. For $100 000, a waiter with six arms, working 24 hours a day, can reject non-standard dishes, and look customers straight in the eye and sing them a song if the hamburger is more than a minute late.

Mail order sales have always occupied a significant place in American trade. Distance shopping -- electronic shopping -- has now been taken over by television, computers, and videotex. According to estimates by Donnelly & Sons, the top American electronic mail firm, the turnover for electronic shopping should rise from $285 million in 1985 to $17 billion by 1990. Eventually, it is likely to constitute about 10 per cent of all retail shopping.

Commerce is going through a period of upheaval. The race for competitiveness -- in terms of price and quality of service -- has brought about profound changes. Major groups are merging and, as in other areas of economic activity, more or less aggressive takeover bids are being made. On the management side, sophisticated computer systems have been installed. Millions of dollars have been invested in computer systems to reduce storage, speed up payment at the cash desk, and shorten the time needed to check credit cards. Technology is an essential element in the new efficiency.

Such is the message from Joseph Baczko, international business manager at Toys"R"Us. In Chapter 29, Mr. Baczko stresses the need for quality management and in-service training of staff in the use of the new tools of management. His second message is that of customer satisfaction -- for example, by staying open the whole year round and by offering the widest possible range of products at all times.

Listening to the customer has become the catchphrase in American marketing: in some big stores, every department manager is obliged to work at the counter for several days a year in order to have contact with customers. Overall efficiency is measured by the index of "earning power".(3)

With respect to employment, the sophistication of the wholesale and retail trades will probably mean an increase in the qualifications required of workers, as well as an increase in their earnings. Staff training will become an element of efficiency in technology and customer relations. In Chapter 30, Walter Loeb, of Morgan Stanley & Co. lists the possible lessons for France from the American experience: more part-time jobs, more late-night and Sunday openings, encouragement of supermarkets, and the creation of speciality distribution networks. But his suggestions are as yet far beyond the mentality and the traditions of the distribution sector in France.

Pierre Dommergues

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Chapter 29

Creating Jobs in Retailing: Toys "R" Us

Joseph Baczko

Toys "R" Us is the largest retailer of toys in the world, with operations in the United States, Canada, the United Kingdom, Germany, Singapore, and Hong Kong. It is a good example of a specialty retailer that has created many jobs in a short time, both in the United States and around the world.

Toys "R" Us was founded in 1948 by Charles Lazarus, the company's chairman and CEO, when he converted his family's juvenile furniture shop into a toy warehouse. The entrepreneurial spirit which produced the first store pervades the company today, as do the rewards that spirit produces. All Toys "R" Us employees, 30 000 worldwide, from entry-level clerks to divisional presidents, hold annually distributed stock options in the company.

Toys "R" Us operates 313 stores in the United States and 37 stores abroad. All stores are virtually the same. In total, they represent more than 15 million square feet of retailing space devoted to toys. Sales in 1988 will exceed $3 billion, compared with $2.4 billion in 1987. The company does not forecast earnings, but for the first nine months of the 1988 fiscal year the company earned $49.6 million after tax, compared with $36.1 million after tax in 1987.

Marketing Strategy

The retailing strategy of Toys "R" Us is simple, direct, and little-changed since the company was founded. But the execution of that strategy has become increasingly complex. It is composed of three basic elements:

First, Toys "R" Us carries the widest possible assortment of toys every day of the year. Stores typically carry about 15 000 items, from infant care products to computers. All major toy manufacturers, and as many small ones as can be found, are represented. Because of its size, Toys "R" Us tends to carry entire manufacturers' lines and does not buy selectively on the basis of customer preferences or lack of space in the store. This is an advantage for manufacturers, because it allows them to sell a wider range of items and to react quickly to individual item demand. In many ways, Toys "R" Us is supply driven.

The second element of the Toys "R" Us strategy is its policy of maintaining permanently low prices. In 40 years of doing business, Toys "R" Us has never had a sale and never intends to have one. Toys "R" Us itself sets prices, not manufacturers. Toys "R" Us buyers must buy effectively, and the staff must move goods through the distribution system efficiently so as to make a profit as well as give the consumer demonstrable value.

Customer convenience is the third important element of the Toys "R" Us retailing strategy. Today's consumer, whether in America or in France, has little time for comparative shopping. In every developed country, consumers have shown a distinct preference for specialty retailing, in spite of lobbies aimed at slowing its development. Consumers prefer a sharply defined product focus. Whether they are shopping for home electronics, fashions, home furnishings, food, sporting goods, or toys they want to be able to find the entire range of the product sought under one roof.

The prototype for Toys "R" Us is the supermarket. Each store has 45 000 square feet, 28 registers, scanning, and some 4 000 linear feet of product. Stores are self-service, shopping carts are conveniently located, and there is parking space for 400 cars. The supermarket approach, which presents huge quantities of branded items mass-displayed from floor to ceiling, twelve months a year, is the Toys "R" Us solution to the issue of convenience. The approach makes multiple purchases of brand names feasible because stores carry complete lines rather than selected items. The wide range of products permitted by the size of the stores has contributed materially to the growth of a year-round market for toys wherever Toys "R" Us operates.

Toys "R" Us and Job Creation

In 1983, Toys "R" Us had 169 toy stores in the United States and no foreign operations at all. Its management staff, which includes general management, merchandising, systems, and store and warehouse operations, consisted of 1 700 people. Full-time non-management staff was composed of 10 000 employees. Today, with 313 stores in the United States, 17 in Canada, 13 in the United Kingdom, 4 in Germany, 2 in Singapore and 1 in Hong Kong, the staff has increased to 3 500 managers and 27 000 full-time non-management employees worldwide. The seasonal aspect of the business swells the employment register considerably with part-time help in the stores and at distribution centers. In 1987, Toys "R" Us employed 75 000 part-time workers for the Christmas season in the United States, and proportionately the same number overseas.

The Importance of Staff Development

The retail business is detail business. The management of detail with respect to 350 stores, 25 distribution centers, 3 000 vendors, and more than 100 million customer transactions is a complex task. It requires skilled professionals in all ranks of management to execute an effective growth strategy. Toys "R" Us has a continuous demand for management in all functional areas, notwithstanding, or perhaps because of, its commitment to increased productivity and profits.

Employment at the store level is largely a function of growth. But even at that level, Toys "R" Us develops its own professional store staff. Some 20 per cent of store management is developed directly from full-time, non-management staff. Typically, a worker enters the store system as, for example, a cashier, is then trained in all aspects of operations, moves on to become a section head, a management trainee, a manager and, finally, a store director. At the conclusion of that process, the person who started as a cashier will have developed the skills necessary to manage a $10 million business at the state of the art of retailing. From that point, he or she could move into area management, or transfer to a central service within the company.

Non-Management Employees

Obviously, not everyone working in Toys "R" Us stores is earmarked for management, nor does everyone aspire to that end. Non-management store workers fall into two broad groups:

First, Toys "R" Us has full-time employees for whom the salary and benefits from a full-time job are the primary source of income to their households. But for most full-time workers, their jobs at Toys "R" Us provide a second source of income to meet family needs or objectives. Quite a few Toys "R" Us employees are young and unmarried. Full-time employment with Toys "R" Us often represents their first real entry into the job market, an essential and all-important step into the world of making a living. For both groups, because the United States has longer store opening hours than elsewhere, Toys "R" Us offers personal work scheduling to meet even full-time workers' requirements.

Second, Toys "R" Us employs part-time workers, a group difficult to define. Certain part-timers have been associated with Toys "R" Us for many years. For some of them, their work there is a permanent second job. For others, it is an opportunity to earn extra money with the least disruption to family schedules or to studies. Whatever their reasons may be, Toys "R" Us depends on part-time workers at peak seasons and for extra coverage during the rest of the year.

Although job creation has not been one of the company's objectives, it has been both a consequence of and a reason for its sustained growth. That growth has had an impact outside the company: in 1988 alone, Toys "R" Us has invested more than $300 million in construction and capital additions, such as store construction, scanning equipment, and tractor trailers, and it has purchased more than $2 billion in manufacturers' goods, all of which advances the cause of job creation.

Toys "R" Us Abroad

Toys "R" Us has encountered some notable obstacles in establishing its operations overseas, particularly in the United Kingdom and Germany. The planning and approval process for new store construction, particularly of the size Toys "R" Us requires, is much more complex, political, and unpredictable than it is in the United States or Canada, and favors town centers and small shops -- conditions that make programmed, deliberate growth difficult. In addition, institutionalized trading hours reflect ways of life and habits that no longer exist. It is difficult to see who benefits from them. Longer, more convenient opening hours do not simply displace trade -- markets are dynamic, not static. While the liberating of trading hours is being discussed everywhere, change is slow because the issue lacks supporters as effective as the advocates of the status quo.

Mr. Baczko is the President of International Toys "R" Us, in New Jersey.

Chapter 30

The Distribution Sector: Evolution and Perspectives

Walter F. Loeb

In the United States, retail stores are increasingly falling into one of two categories: convenience stores and destination stores. A destination store is one to which clients are willing to travel considerable distances, sometimes as much as 40 kilometres. Convenience stores, such as a Prisunic in France, are generally frequented by customers from the immediate neighborhood.

Another distinction exists between fashion and commodity retailing. Because they sell items that are heavily discounted in the United States, such as television sets, VCR's, and calculators, commodity retailers are very price conscious. The same is not true of fashion stores.

The best example of a fashion destination store is Harrods in London. People come from all over the world to shop there. In the United States, Bloomingdale's and Nordstrom's are fashion destination stores, as is Galeries Lafayette in Paris. The BHV in France is a destination store for the do-it-yourselfer, similar to the warehouse stores in the United States.

It is the destination stores that have the greatest opportunity for growth and employment creation in the 1990s. They attract consumers and require strong sales support systems and efficient warehousing. The fashion innovators will be the real winners in terms of their expansion opportunities and their ability to create jobs in the future.

Tomorrow's Growth is Beginning Today

The basis for the growth in retailing that will take place in the 1990s lies in the present. For instance, direct marketing (or non-store retailing) is growing substantially through interactive electronic sales, catalog sales, and even home shopping by television. TV home shopping will need to improve by changing its format and by selling better merchandise, but people will shop by computer or television if the quality and value of items can be demonstrated. Computer and TV shopping are the least labor-intensive areas of retailing, but they do move merchandise and therefore they compete for the discretionary dollar.

The development of supercenters is an important trend for the future. Perhaps inspired by the success of warehouse stores and the entry of France's Carrefour and Euromarché into the United States, the Wal-Mart group developed a new 22 000 square meter store concept called Hypermarket USA. The first Hypermarket USA opened in Texas in December 1987 and employs over 800 people. Three more stores will open in 1988. K-Mart intends to open a giant store, and undoubtedly other retailers will as well. Wal-Mart's Hypermarket is open from 7.00 a.m. to 11.00 p.m. every day of the year and should achieve more than $100 million in sales in its first year, albeit at extremely low margins -- no more than 13 per cent.

Discount stores will continue to expand, but they will emphasize fashion textiles because so much of commodity retailing, electric and electronic goods, is being taken over by warehouse stores at margins that are not profitable for most retailers. K-Mart has already indicated that it will devote an additional 400 square meters in each store to fashion textiles by shifting merchandise and eliminating unprofitable classifications . The tendency is toward increasing productivity and operating profits per square foot. Super stores, particularly those adjacent to food markets, will enjoy even greater sales and productivity in the future.

Although department stores remain a major attraction in shopping centers because of the wide variety of their merchandise, they are essentially mature and have no great expansion opportunities except through acquisition. But specialty stores and fashion boutiques are going to grow at a much more rapid pace because they dominate each classification they sell and the customer recognizes them as excellent places to shop and to save time. It is in this sector that an entrepreneur can most easily start a new venture.

Evolution, Not Revolution

Retailing is never revolutionary, it is evolutionary. Everything builds on the past, and new forms of retailing are developed on the experience of past formats which do not disappear when new concepts emerge. For instance, discount stores were the first phase, followed by warehouse stores, and now we see the initial attempt at hypermarkets. Similar examples exist in all other classifications -- for example, electronics, sporting goods, auto service, and do-it-yourself. In most cases, the future belongs to the larger stores, which are more efficient and productive.

Retailing in the United States is growing, due to low-margin, high-volume stores and fast-developing specialty stores, which generate high earnings and a high return on investment. The expansion of retailing creates jobs in the stores, and in the support systems that supply and supervise the stores.

Increasing Productivity

Retailing is a growing industry. In 1986, total retail sales in the United States amounted to $1.5 trillion, an 8 per cent increase over the previous year. Employment in retailing in 1986 increased by 7.5 per cent, to 16.9 million people. Department stores accounted for 9.9 per cent of total sales, ($149 billion), and 11.8 per cent of the total workforce, (2 million people). Apparel and accessories stores accounted for 5.1 per cent of total sales. ($76.6 million), and 5.9 per cent of the total workforce. (1 million people). Eating and drinking establishments accounted for 9.6 per cent of total sales. ($144.8 billion), and 34 per cent of the total workforce.

What accounts for the discrepancy between the restaurant and drinking trade and other retailing categories in which workforce and total sales are closely interrelated? The sharp rise in operating costs has made productivity very important to general merchandise retailers, and they have reduced their workforce by introducing sophisticated management techniques. The following table shows that between 1967 and 1986, output per employee hour has increased 2.8 per cent, but the number of employees has increased by 0.8 per cent. Productivity has increased due to careful scheduling of workers and increased use of part-time help.

TABLE

Indexes of Output per Employee Hour, Output per Employee.
Output, Employee Hours, and Employees
(1977=100)

	Output per Employee Hour	Output per Employee	Output	Employee Hours	Employees
1967-1986	2.8	2.0	3.6	0.8	1.6
1967-1973	1.8	1.3	5.6	3.7	4.2
1973-1980	2.9	1.7	3.0	0.1	1.3
1980-1986	4.5	3.8	4.8	0.4	1.0

Source: U.S. Department of Labor, Bureau of Labor Statistics
Office of Productivity and Technology.

Sunday Openings

Stores in the United States are open many more hours than stores in France, often until 9.00-9.30 p.m., and on Sundays from 12.00-6.00 p.m. During the 1987 Christmas season, some stores were open all night, while others had "midnight madness" sales, staying open with special sales until midnight. As a result of the long opening hours, retailers today schedule more part-time employees than ever before. Part-time workers provide retailers with the flexibility to schedule their workforce profitably. And the low salaries and minimal fringe benefits accorded to part-time employees gives retailers a less costly workforce than the use of full-time workers would permit.

The United States has few restrictions on working on Sunday. In the past, for religious reasons, only food could be purchased on Sunday; all other stores were closed. Today, most states' "blue laws" limiting Sunday openings have virtually disappeared, except for state laws prohibiting Sunday sales of liquor, usually until 1.00 p.m. Only four states, North Dakota, South Dakota, Alabama, and Oklahoma, still have blue laws. An odd situation prevails in New Jersey where the state gives local jurisdictions the right to impose blue law restrictions. There, one county forbids the sale of general merchandise on Sunday, but retailers in a neighboring county where Sunday shopping is permitted enjoy substantial Sunday trade.

By opening on Sundays, stores have added a net gain of 5 per cent to their total business and have shifted 11 per cent of the week's sales to the Sunday hours. They have increased their sales personnel by as much as 5 per cent and non-sales personnel by approximately 4 per cent. Selling cost has increased to slightly above 5 per cent, because usually workers are legally required to be paid overtime rates. Saturday and Monday sales are reduced by Sunday opening hours. Opening stores on Sundays does not reduce costs, but it creates jobs.

If, as is sometimes argued, the French are not in the habit of shopping on Sunday, it is because the stores are closed. If they were open, the habit of Sunday shopping would develop very quickly. The absence of tradition is not a reason to keep stores closed on Sunday. An important purchase is a family affair, and Sundays are when most families can unite for the occasion.

Night-time Openings

Night-time store hours have a similar positive effect on sales and employment opportunities. Recent studies indicate that a 20 per cent increase in opening hours accounts for about 30 per cent of total sales and a doubling of the number of part-time employees. Discount stores in rural areas realize 20 per cent of their sales at night. In city and suburban areas, night-time hours account for 35 per cent of their sales. Department stores achieve 30 per cent or more of their sales at night. Only fine specialty stores, like Saks Fifth Avenue, have a lower percentage of evening hour business. Again, families like to shop together for major purchases, and evening hours make this possible.

Part-time Employees

According to a government survey, 41 per cent of the employees in department stores, 42 per cent in clothing stores, and 52 per cent in eating and drinking establishments are part-time workers. But those figures underestimate the real situation: at present, part-time employment in department stores is in reality more than 60 per cent, and in clothing stores it is probably closer to 65 per cent.

Recently, however, there has been a reversal of this trend, and full-time workers are beginning to be hired in greater numbers because some retailers have become convinced that part-timers are inclined to absenteeism and too-frequent job changes. Also, in some regions of the United States, there is a scarcity of young people, who constitute much of the part-time workforce, so that stores have to transport workers from distant areas. This is costly because employers are required to offer such workers higher pay, as well as payment while being transported. It is an unprofitable system for retailers, who concurrently noticed that people who really want and need to work prefer full-time jobs. Some major stores have already begun to reflect this perception in their hiring practices.

Retailing and Job Creation

There are a number of ways in which retailing is contributing to job creation in the United States. Retailers are focusing on expansion, and expansion creates jobs. Some companies, The Limited, for example, are expanding with 450 new stores annually. And retailers are diversifying, creating an environment for new ideas and opportunities for growth. For instance, The Gap -- a specialty clothing store -- recently developed Gap Kids and also diversified into Banana Republic, another specialty operation featuring safari clothes. The Limited created Limited Express for younger people, and Toys "R" Us has launched Kids "R" Us as a separate operation. Finally, retailers are turning their attention to acquisitions. Frequently, when a major firm acquires another similar operation it means faster growth, because the resulting combined operation has more financial strength. Such was the case when May Department Stores acquired Allied Stores.

Retailers are optimists and entrepreneurs. They have the confidence to launch new ventures and they find the means to finance them. They know how to use successful sales strategies, such as longer opening hours, to enhance their growth.

Comparing Retailing in the United States and France

Retailers in the United States are less restricted than their counterparts in France where the Royer Law protects small shopkeepers. There is little regulation to limit U.S. retailer's expansion. In the United States, regulation is less a psychological barrier to growth than it is in Europe in general and in France in particular. For example, in the United States it is easier to identify and dismiss unproductive employees, and retailers can utilize part-time employees more profitably. The turnover rate for part-time workers in metropolitan areas is very high. This flux continually increases employment opportunities.

What specific lessons about job creation can France derive from the American retailing experience?

i) France could encourage greater use of part-time employees.

ii) Encouraging evening hours would create 15-20 per cent more jobs. Even if as a result small shopkeepers have to hire more people in order to survive, they would prosper nevertheless through higher sales, which would benefit the retailing sector as a whole.

iii) French consumers would learn a new way to shop if stores were permitted to be open on Sundays. The system could be initiated in Paris and its suburbs, and then expanded gradually into other regions.

iv) A climate more conducive to growth would be created by encouraging the development of more destination stores and commercial destination centers.

v) France should encourage new ventures in specialty stores.

If the measures outlined are adopted, the ultimate beneficiaries will be French consumers. The new opportunities for employment will increase their buying power, thus contributing to the cycle of growth.

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CONCLUSION

Chapter 31

Between Fascination and Rejection:

Reflections on American Success

Jean-Daniel Tordjman

There are two pitfalls to avoid when confronting American job creation success. The first is fascination, with its resulting urge to effect a complete reprogramming based on the American model. The second is to reject out-of-hand any possible instruction. In the opinion of some observers, the creation of unstable, under-paid jobs is a dangerous phenomenon, one which destroys real, well-paid jobs. For others, job creation in the United States may be explained by the American budget deficit and its external financing, a phenomenon which by definition cannot be duplicated elsewhere. Still others consider the dominant factor to be the "dual society", based on the severe over-exploitation of minorities.

Values and Behaviour

As always, there is some truth in each of these explanations, but it seems absurd to deny categorically that there are lessons to be drawn from American job creation success. The question of behavior is fundamental, and in that regard it is clear that the French and Americans differ, in their values, their priorities, and their social organization.

Our values are close, but not identical. The Americans hold to only one part of the republican credo and accord to other ideas a different meaning. Regarding liberty, the debate in France concerns formal liberties as opposed to "real liberties." In the United States, the debate concerns civil rights and incursions into the rights of women, homosexuals, and racial or religious minorities.

Equality does not figure among the priorities which give value to the notion of self-reliance, of counting on no one but oneself, a notion which carries a multitude of economic and social implications. Nor is fraternity included among the American republican virtues, which stress independence, compassion and religious faith.

The two nations also differ with respect to collective behavior. Tocqueville remarked as early as 1825 that "the French are passionate about ideas, the Americans are passionate about money." The ideas of "parvenu", or "nouveau riche" exist little, if at all, in the United States, where "new money" and "old money" are equally valuable. Unlike the French, Americans attach little importance to what one says, but more importance to what one does. Your "personal record" is an essential element of your personality, and the crucial point is that "actions speak louder than words."

For centuries, the highest priority among the most ambitious of the French was to "serve the Prince;" for the Americans, it was to succeed, or, stated less delicately, to make money. Twenty million Americans change jobs every year; by contrast, Fernand Braudel has shown that until 1945, 95 per cent of the French passed their lives within 50 kilometers of where they were born. But despite the differences which underlie economic behavior, there are lessons to be learned from American success in the realm of employment.

Inspiration from the American Experience

Why, after all, have so many jobs been created in the United States, and what lessons can be drawn from that experience?

First, in the United States unemployment is not considered to be inevitable or irrevocable. Unlike European countries, the United States did not approach the problem by trying to learn to live with several million people out of work, but by trying to make unemployment recede. The results, in this respect, are convincing.

Second, in the United States it is not the amount of work but the number of workers that is taken as a given. The notion that a fixed amount of work must be shared among all workers is essentially European. The Americans are motivated by enterprise, the will to win more markets. There are no limits for those willing to work harder - and harder work often results in the creation of more jobs.

In drawing inspiration from American experiences, the French could work in these directions:

i) France could conquer more foreign markets. If French companies were to create more jobs directly linked to exportation, there would be a double result: immediate net job creation, and, at the same time, positive spill-over in terms of orders for other French companies, which in turn would strengthen markets.

ii) France could increase its effort to promote tourism. Tourism is one of the most lucrative service sector investments. Transport, hotels, restaurants, trade and leisure activities all create jobs.

iii) France could better adapt store-opening hours to existing and potential customer demand. Each year, France welcomes more than 33 million tourists, to say nothing of the millions of foreign visitors who are not counted as tourists but who come to France for long weekends. Sunday store hours, targeted at areas with a high density of tourists, would have a positive effect on the balance of payments.

Labor Costs and Mobility

Labor costs in the United States have been on a consistently downward trend since the beginning of the energy crisis. The average real hourly wage is equal today to what it was in 1968. The minimum wage has been fixed at $3.35 an hour since 1980. In real terms, the average hourly wage declined 6 per cent between 1977 and 1987. Even more surprising, average real income for families has improved very little in twenty years. An American family that earned $28,213 in 1969 (in 1986 dollars) earns only $29,458 (in 1986 dollars) today. Similarly, average real wages for full-time male workers have shown practically no improvement since 1969. In the United States, job creation has largely taken place at the cost of doing without wage increases, which means that for a long period real purchasing power has not improved.

Mobility is another factor favorable to employment. Americans are more mobile than the French, socially and economically. To the cultural reasons for this difference mentioned above must be added the tax consequences of real-estate transactions. In the United States, the cost of moving is generally 1 to 2 per cent, whereas the analogous cost in France is generally about 7 per cent. This surcharge militates against mobility in France.

Financing Mechanisms and the Quality of Employment

Innovative financing formulas allow small and medium-sized businesses to strengthen equity. In France, as in the United States, the high cost of start-up loans partly explains the high mortality rate of such firms. The Americans make use of a formula, however, which deserves to be adapted for France. The Limited Partnership allows the investment of personal savings, one's own and those of friends and associates, without the payment of interest, (because it is not a loan), while limiting exposure to the amount of the initial investment and allowing tax relief in case of loss. This mechanism has contributed to the creation and success of many small and medium-sized businesses in the United States. In general, any formula that facilitates the build-up of equity and the reduction of debt service has a positive effect on employment.

Many of the jobs created in the United States during the past fifteen years have been unstable, badly paid, and without any benefits. Thirty-seven million Americans have no health insurance. But it would be overstating the case to assert that all of the new employment is of that type. A substantial number of the new jobs are well paid - in financial, paralegal, medical, and computer services for example, and include desirable fringe benefits.

Conclusion

Four key ideas emerge from the American example. First, wealth, and job creation, belong to the private sector. But government, especially local authorities, have an essential role to play in the creation of the business climate, particularly by legislation (to authorize Sunday store openings, for example).

Second, all public action should be measured by the standard of market reality. An economic or social program which does nothing more than passively spend public funds will have no long term effect. All public spending should be an investment.

Third, priority should be given equally to the availability of public and private funds and to the management of technology and people.

Finally, it is cultural factors which play the decisive role in economic revitalization - mentalities must be changed. On this point the Americans are ahead - those who have always believed that there is nothing inconsistent between service and self-improvement, that to conquer is not necessarily to subjugate, and that adapting does not mean giving in.

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Chapter 32

What Can We Lean From the Americans?

Philippe Séguin

Closing speech to the OECD seminar made on 22nd January 1988
by the French Minister of Social Affairs and Employment

American experience obliges us to question our economic and social analysis of employment problems and our cultural approach to them. The United States is a vast laboratory of economic and social experience to which we should refer, not so much as a model to imitate but as indicating certain directions we might investigate.

What are the fundamental data concerning employment, both in the American economy and in other industrialized countries? What are the challenges facing us, especially those linked with the inevitable decline of Taylorism and the labor force at large?

The Americans have experienced and are still experiencing economic and industrial catastrophes: competition from Japan and the newly industrialized countries of Asia has severely affected the metal and metalworking industries, and part of the electronics industry. Entire regions have veered from prosperity to mass unemployment. But the Americans appear to have reacted quickly and effectively to new circumstances. They have thought it over and have launched a new approach to economic development and employment. That approach has two aspects, both of which are pragmatic. First, it involves cooperation among many partners including the states, local authorities, universities, and industry. Second, it is a deregulated approach based on the immense development of employment in services, part-time work, self-employment, the mobility of people and businesses, and the flexibility of pay and forms of employment.

Employment in the United States is a Complex Matter

It is not possible to take a simplistic view, and measure the efficiency of what is called the "job machine" by the yardstick of the statistics, spectacular though they may be.

Certain additional qualitative remarks must be made to qualify the quantitative data. One important phenomenon must be underlined: the mass entry of women to the labour market. In less than ten years, the female participation rate has risen by 10 points in the United States, compared with 3.9 points in France. This movement, which is gathering pace, no doubt corresponds partly to women's desire for emancipation -- the feminist movements have been very influential -- but also to the need for a second income to maintain households' standards of living. The less-qualified, more flexible female workforce, accepting lower paid jobs, has been the substratum for the new type of employment created, essentially in the tertiary sector.

Secondly, it is important to take a dynamic view of American employment. We must increasingly include this component in our work re-entry strategies -- in other words, we must take account of movements in employment and not merely trends expressed in absolute figures. What we call the "turbulence" of the American economy is an important subject of discussion. Employment growth is fed by the process of job creation-disappearance-rebirth: the faster the movement, the more jobs there are.

Analysis of this "turbulence" confirms that job creation in the United States is due primarily to small firms -- those with fewer than 20 employees account for 88 per cent of net employment creation. This means that if growth potential exists in France, it is not fully used.

Third, part-time work is an important and traditional element of the world of work in the United States. The proportion of such jobs is much greater there than it is here. They are often the first jobs held by young people and students, who are thus initiated to work and working life.

About 18 million of the 115 million American workers "float", according to the official statistics, between one trade and another, working for half the year, so that many of them are poor and live below the official poverty line ($11 200 a year for a family of four). This puts a substantial burden on the community, and the cost is borne by the public sector.

Thus, in the United States, you can work and be poor -- in other words, not have the basic minimum. This is due to the minimum hourly wage being low -- about $3.35 an hour -- with practically no social charges. There is little social protection for most low-paid jobs. Hence the growing "social polarization" particularly stressed by Professor Bluestone in Chapter 7. At the same time, we must also remember the six million Americans who have given up looking for work -- the discouraged workers.

All of these aspects take us far from the classical concept of full employment based on the broad labor force. These are the responses, with their strengths but also their weaknesses, made by the Americans to the new economic challenge at the end of the 20th century.

Several major ideas emerged during the seminar and are addressed in this book. The United States has realized that, in the post-Taylorism era, the new deposits of wealth and jobs were less to be found among the major national or multinational groups than among innovative small and medium sized firms. It has appreciated that innovation depends not only on technology but also on imagination, audacity, and hard work. Performance can and must be good, not only in high-technology industries but also in middle- and low-technology industries. The Americans also know that while the greatly expanding service sector often implies low-paid jobs, it also creates skilled employment, and employment in which training will become more and more important.

Job Creation Depends on the Development of a Local Economy

The job creation capacity of American society is based today on the development of local economies. Thus, we are witnessing the emergence of a "territorial economy". Growth and job creation are not determined in Washington, but in Boston, Massachusetts, in Ann Arbor, Michigan, and in Atlanta, Georgia.

Jobs are created by specific decentralized programs. Take the spectacular example of Lowell, Massachusetts -- a small city which in less than ten years succeeded in reducing its unemployment rate from 15 per cent to 3 per cent; or the example of a rundown district on the outskirts of Washington which took its destiny in its own hands and created a service industry. Thousands of small firms generating thousands of jobs are being set up in this decentralized, newly autonomous context.

In Chapter 4 James Howell emphasizes that the creation, expansion, and diversification of small local firms is the road to employment growth. He outlined the conditions for success: Small and medium-sized enterprises must be competitive both at national and international levels. And they must grow out of a favorable environment created by all the local partners working together within the community.

Economic development and job creation involve cooperation which, until recently, was neither necessary nor possible. In the 1960s, employers set out to conquer markets alone. Relations between the economic and social partners were often strained, often even adversarial.

Today, the spirit of initiative is still essential, but even more important is the ability to work together, to cooperate on common projects and to launch operations in association with partners. The spirit of enterprise -- entrepreneurship -- is taking shape in the ground of cooperation -- the partnership.

Partnerships

Partnerships are primarily organic collaborations among local elected representatives and economic decisionmakers. Partnerships are organized around specific projects which enrich the community and provide something for each partner -- industry, the universities, local government, and the community.

Projects can be as small as the creation of a business incubator, or they can involve coordinating the economic development of an entire city, such as Baltimore. They can aim to change the environment of cities and their suburbs, as was the case in Pittsburgh, a once-fallow city which in 20 years has become the seat of the largest American multinational companies.

Partnerships may be organized on a regional scale. As Peter Plastrick discusses in Chapter 10, Michigan industry, universities, and public authorities are working in unison to preserve employment.

Partnerships rely heavily on university research. Research contracts have always been more plentiful in the United States, where private universities often depend on industry to develop research programs.

What is new in university/industry partnerships is the appearance and rapid development of many forms of "cooperative research". Often undertaken at the instigation of local authorities and co-financed with business, cooperative research is undertaken jointly by university researchers and industry. Such programs help to develop fundamental and applied research in the "pre-competitive" phase. In Chapter 14 Herbert Fusfeld underlines the importance of this cooperation -- at local and global level -- in a world increasingly dominated by the circulation of scientific and technical information.

Whatever the legal forms of university/industry cooperation, each partner benefits from the partnership: industry saves time and money from jointly performed advanced research, universities are more directly involved in industrial programs, and university researchers work part-time as consultants in the industries concerned. As for the local authorities, the main advantage for them is that businesses are created, directly and indirectly generating wealth and jobs.

Finally, it must be observed that most new employment is not due to these partnerships -- which generate steady, well-paid and what one might call "noble" jobs -- but rather to a multitude of service businesses. Indeed, the big battalions of new jobs are found in trade, distribution, hotels and restaurants, and in the "new" services.

Two Forms of Economic Development

The United States would appear to have currently two forms of economic development. On the one side, there is "concerted development", based on industry/university/local government partnerships, which forms the hard core of tomorrow's competitive economy. Concerted development creates a limited number of jobs, but with high growth rates. On the other side there is "deregulated development" which takes advantage of the quality of the environment created by the partnerhips but which pursues a strategy of short-term supply in which the originality and quality of service take precedence over any attempt to improve productivity. This is the daily search for new markets and new activities.

Such jobs are increasing at an astonishing rate in a country which traditionally has an almost inexhaustible supply of and demand for services. The "convenience industry", as it is now called in the United States, is growing in many areas which often take us aback: home catering, teleshopping, maintenance (your car tires changed on your doorstep, for example), and domestic cleaning by firms that previously offered their services to businesses.

This is a sector in which, as the Americans say, "risks and opportunities go hand in hand". Each supplier must prove that, for less cost, he can save you time, release you from daily chores, and improve your quality of life.

These jobs do of course tend to be unskilled, insecure, part-time and badly paid. Yet certain experts have discerned some interesting trends. In the field of distribution, Walter Loeb explains in Chapter 30 that these industries are accelerating the process of modernization, which eventually will bring higher productivity. And although this might mean fewer jobs, jobs will become more skilled and better paid. Is this not a sign of a possible transition from insecure employment to more skilled employment, and the beginnings of a change from extensive employment growth to higher quality intensive growth?

Equally notable is the rapid development of the new services which are supplied in the United States by mixed or private institutions, such as Kinder Care, through a widespread network in response to the unsatisfied demand for crèches, day nurseries and nursery schools. In Chapter 26 Rick Surpin, who runs a health care cooperative network in New York, emphasizes the magnitude of the demand for and supply of health services in that city. In Chapter 25 Kimi Gray shows how jobs were created for a poor black community to renovate housing, run a local cooperative, and open day care centers. These are interesting possibilities to consider.

Innovative Financing

The private sector, industries, banks, and foundations provide most of the funding for the new partnerships. In Chapter 24 Craig Kennedy explains the importance of the role of private foundations. The public partners take full advantage of leverage. The public sector often provides initial funding, but for every dollar invested it demands that each of the other partners invest at least the same amount. The multiplying effect can be astonishing: it is not rare for one public dollar to generate one, two, five or even ten dollars.

The availability of capital and flexible financing mechanisms are essential to create or expand businesses. In Chapter 20 Pierre Lamond, head of the Sequoia Capital venture capital company, speaks of the global approach of venture capital companies, which contribute as much management consultancy and engineering as they invest in dollars.

Ronald Grzywinski, President of the South Shore Bank in Chicago, discusses in Chapter 22 how certain banks can take risks in local development operations, and shows how important community savings can be. Likewise, many local governments help to finance operations that are too risky for banks and not profitable enough for traditional venture capital, yet which are nonetheless vital to support local businesses. And the surprising outcome is that states which have loaned money to fill the "gaps" left by the private sector have, on the whole, not only recovered their stakes but have recovered them with interest.

We Must First Change our Mentality

What are the lessons of American experience? The common denominator emphasized by the exceptional panel of elected representatives, businessmen, financiers, researchers, trade unionists and organizers of associations, both American and French, who participated in the seminar is that economic development and job creation strategies, while involving technology and capital, also require investment in human resources, an active partnership, a pragmatic approach, great flexibility on the part of people and industry, and the acceptance of rapid changes in outlook and behavior. This is an undeniable advantage of industrial life in the United States.

We must begin by changing our mentality and our ideas if we want to face the economic and social challenges of tomorrow. That is the first lesson of American experience. But we must not try to simplify matters by taking a mistaken view of the mechanisms which operate in the United States. For example, it is a mistake to believe that the basic principle of American dynamism is laissez-faire. It has been amply demonstrated that the Americans, who are realistic people, do not think that market mechanisms can on their own settle all problems. The "do nothing" credo has, as we have seen, been followed by the maxim "let's do it together".

It is surprising to see, in the traditional context of a certain distrust by business of any form of interventionism, how economic development policies have been introduced -- especially in the industrial states most affected by the last recession. These policies have aimed above all to create a favorable environment for the expansion of the existing industrial fabric and for the creation of new businesses. They are characterized by their variety, pragmatism, and determination to involve the entire business and social community.

It is also a mistake to believe that inertia and resistance do not exist in the United States: people who are assisted tend to perpetuate their assisted status, and union disputes can be very bitter, with strikes lasting longer than they do here.

There is, however, one fundamental cultural difference: most Americans believe that nothing is ever permanently settled, that there is always a way out, and that it is normal to have ups and downs. For us, the crisis is structural, it concerns the long term. For the Americans it is cyclical, bad phases are followed by good. This means, notably, that failure is a right and can even be valuable, since it has an educational value. Here, we speak of "a perfect career". I believe that this different cultural approach to problems is fundamental; we should pay particular attention to it.

Real Actors, Able to Work Together

One of the key factors of American experience is that local development is based on the existence of real actors and their ability to work together. In France, you are an actor by right, because it is only proper or because you represent an institution. Yet such status does not necessarily confer the ability to spark development. Usually, the result is a practice well known in football: marking your man. Instead of encouraging initiative, the game consists of making sure that no new initiative raises any problems, or challenges established positions. We are too often in the habit of operating like that, thus condemning any initiative in advance.

In the United States, many projects are carried out by fully responsible actors working collectively as partners. This means that each partner exercizes initiative unhampered by tight rules or stereotyped language. Each player employs technical skills which bring out those of the other actors.

Who takes the initiative in partnerships? Here, everyone keeps to his own role and often waits for the initiative to come from someone else, especially central or local government. This idea of the public sector as the source of all initiative must be banished. The government encourages and supports initiative, and plays a modest role. This necessitates extensive decentralization of decisionmaking and action, which is only effective if responsibilities are assumed at every level.

It is not certain that decentralization has been organized in France in that way, since nothing fundamental has changed in the nature of relations among the actors: the State is too powerful in its attributes but is powerless to mobilize. The State has been partly replaced by local actors, who are equally powerless and isolated within the hierarchy of their responsibilities. The problem of employment growth at local level should be tackled more in terms of a real community.

The "civic duty" of industry must be mentioned. But the personal contribution of members of the business community whose skills can create and direct development must not be confused with industry being "made to help", which would weaken the strength of businesses.

School and University: Full Partners

A clear message from the seminar is that education, training, and research play key parts in the creation of a favorable environment for economic and employment growth. School and university are full partners in local development. Two aspects of the collaboration between the academic community and the economy have emerged. The first has not so much been considered explicitly as incidentally: it concerns the link between education and training, and employment. The need for a continuum between education and employment, and the need to provide the means for training or retraining manpower, have emerged as the two main targets. The alternating training scheme set up in France endeavors to pursue these aims.

The second aspect concerns the relationship between university and industry. The Americans are more skilled than we are in associating researchers with firms. The latter help to fund university research, and themselves exploit research and make use of researchers; academics and researchers themselves do not hesitate to become entrepreneurs. These worlds do of course stay separate, and some strains remain, but that does not affect their collaboration in dynamic partnerships. These results are partly due to the universities' ability to direct their research programs independently, entering into contracts with government or industry what is called "cooperative research" in the United States. It is not always easy to mobilize the actors, but they have learned to do it, notably by sharing information. Joining forces to look at the facts and to make a diagnosis is a powerful factor for efficiency. In order to share a view, you must first be able to talk to each other. Looking at the facts together also means evaluating your resources, advantages, strengths and weaknesses, and preparing to mobilize your abilities.

The Need for a New Analysis of Employment

We should try to engineer more extensive employment growth. The statisticians, who have problems in aggregating components such as local dynamism and innovation, tell us that the gap between the labor force and employment will widen further in France, and that unemployment has become a structural factor in our society. All this is true given our ideas, our culture, our form of organisation, and our legislation.

We must confront this situation by preparing for the future. First, we must adopt a new analysis of employment. We are still living with mentalities, language, institutions, and legislation which were devised for a full-employment economy based on high growth. In such an economy, employment is seen primarily as a full-time job for an indefinite period with a single employer, accompanied by coverage for sickness, unemployment, and retirement. The first economic difficulties gave rise to what we called atypical employment, and the Americans, for their part, were quick to adjust to this new factor.

France is experiencing an apparent contradiction in this connection. The right to work, in legislation and regulation, is highly developed and is often regarded as too rigid. To facilitate the development of new forms of employment, we must adopt further legislation and regulations in order to relax the rules. This reflects the transitional character of the period we are experiencing and the attempts made to facilitate that transition. There is no ready-made solution.

The target of full employment in the traditional sense is no longer realistic. This must be said, even if it is difficult to accept. We must find new frames of reference. What types of employment should we then aim for? In the United States, flexibility of employment -- as part of a generally flexible economic system -- creates many new jobs. We should investigate this, and we will probably have to accept the existence of economic sectors in which productivity improves less quickly, which means that their labor costs are relatively lower.

The Need to Combine National Solidarity, Flexibility, and Economic Integration

What are the consequences and objections? In the United States, flexibility, in practice, means low wages. Our own SMIC is well above the American minimum wage. Flexibility means low social protection. It sometimes leads to poverty. These are real dangers which we dare not underestimate, and we cannot follow the American example in this area.

We must combine national solidarity with flexibility and integration in economic and social life. Flexibility might facilitate the integration of the labor market's also-rans and unemployment's welfare cases, and it might be a first step toward work entry. It is not possible to accept the exclusion from employment which leads to social ostracism. Work is preferable to idleness, which means that if we can generate employment, we must do so. But at the same time, in the name of national solidarity, we must retain social coverage and also accept that some will pay less towards it.

Flexibility permits the development of part-time and casual employment, and creates conditions enabling the jobless to work, albeit with shorter hours. That is what we have begun to do by allowing the unemployed to work for up to 78 hours per month on part-benefit. In the United States, people who work half-time regularly in this way would not be regarded as job seekers. A gradual transition from idleness to employment must be permissible. That is the direction taken by modern societies. It is the price to pay for more effective work entry.

Flexbility also means gradually loosening the constraints which make certain aspects of the right to work operate against employment. Take the example of the SMIC: luckily, no one challenges it; yet, to encourage employment, we are increasingly accepting situations where the SMIC is not applied.

Should we not then look at the situation squarely and calculate what flexibility we can accept to increase employment, with how much solidarity, and for whom? Negotiation is very definitely the right way to clarify such collective choices.

Encouraging New Trades and Types of Employment

Does France have a potential deposit of more extensive employment? My answer is yes. American experience proves that we have a real margin, notably in services in the broad sense. They account for 70 per cent of employment in the United States, compared to less than 60 per cent here. We must not fail to explore this sector in order to encourage new services and new trades everywhere, mobilizing local actors and the private sector.

Job creation margins can be found in the social sector by taking a more entrepreneurial approach to the social function. The Americans are showing us that "social enterprises" can emerge and prosper. Consider the new and probably solvable needs which arise, for example, from the constant increase in the number of elderly people.

This approach in terms of future or continuing services prompts us to question the sometimes too rapid process of capital/labor substitution that we have begun. In sectors not directly subject to international competition, not only can employment be preserved but it can also be made to grow by improving the quality of the services offered and broadly expanding the "convenience industry". Recent experience and practices adopted in the United States prove that the customer, the consumer or the user wants ever more consideration, more facility, and more convenience.

In France, we have launched into the development of the supply of services in the non-trading sector with community work, local work-entry programs, and local income supplements which also have a social reintegration purpose. With the tax incentives granted to encourage an increase in home work and to develop intermediate associations, we have cautiously broached the trading sector.

We must now consider the economic conditions leading to a broader scale of new trades and in particular to the cost flexibility which must be accepted. We must then address the question of employment in small firms, and self-employment. A framework must be built to combine solidarity, flexibility, and economic and social integration.

Employment yesterday concerned the broad, industrial workforce. Employment today concerns a more fragile workforce. Employment tomorrow will depend on skills and performance which will be acquired through alternating work and training. Such developments are difficult to manage. We must simultaneously address today's dangers and build the framework for tomorrow.

During this seminar, the American speakers told us what we all knew but find difficult to accept: these developments are slow. It takes time to change legal and economic institutions, men and women, mentalities and skills. Yet this time is measured for us by the urgency of the problems of employment. Routes have been indicated; possible choices have been clarified. We are capable of taking up the challenge of unemployment. We must know what we shall have to pay, and set the time limits. We must lay our bets on both flexibility and solidarity. But we know that hope exists.

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